



Tuck School at Dartmouth

**INTERNATIONAL CORPORATE GOVERNANCE
Spring 2007**

B. ESPEN ECKBO

Tuck Centennial Professor of Finance and
Founding Director, Center for Corporate Governance
201 Woodbury Hall
(603) 646-3953
b.espen.eckbo@dartmouth.edu

BETH PERKINS

Academic Coordinator
203 Woodbury
(603) 646-3412
beth.perkins@dartmouth.edu

COURSE DESCRIPTION

This course debates corporate governance systems and practices around the world. We begin with the fundamentals of law and finance: how a country's legal system affects cost of capital and financial development. We then move more specifically to conflict resolution between the various constituencies of the firm, including incentive alignment between owners (shareholders) and their representatives (board and management), and the need to protect fundamental shareholder rights. There is a growing recognition of the need for reforms that reduce shareholder costs of monitoring management. Proposed reforms include greater transparency in issues ranging from accounting standards to executive pay and to corporate social responsibility. There is also a strong movement, especially among pension- and hedge funds, to reform fundamental shareholder rights. Proposals include simplified board election processes, and enhanced opportunities for binding shareholder resolutions at the general meeting. Collectively, these proposals radically alter the balance of power between shareholders and corporate insiders. Corporate insiders often resist reforms that bring shareholders "too close" to the firm's decision making processes. The course brings out this controversy through a combination of lectures, academic readings and in-class debate with industry leaders.

GRADING

- Class Participation, 35%
- First Group Project, 25%: 15-minute presentation of a single recent governance case related to one of the class topics.
- **Second Group Project, 40%: In-depth case study of a governance controversy set against the background of the governance system of a selected country. Due for presentation in a three-hour session at the end of the course (classes 17 and 18).**

INTERNATIONAL CORPORATE GOVERNANCE
Professor B. Espen Eckbo, Spring 2007

<u>Session #</u>	<u>Date</u>	<u>Topic</u>	<u>Class Visitor</u>
THE INTERNATIONAL GOVERNANCE DEBATE			
1	Mon 3/26	Corporate Governance and Investor Protection	
2	Tue 3/27	Law and Finance: A Global Perspective	Prof Rafael LaPorta
CONSEQUENCES OF SARBANES OXLEY			
3	Mon 4/02	SOX Reforms – View from the Audit Committee	Art Lindenauer
4	Tue 4/03	Changing the board: Proxy Contests	David Drake
5	Mon 4/09	SOX and Director Election Reforms	Dean Paul Danos
HOSTILE TAKEOVERS: LEGAL AND ECONOMIC ISSUES			
6	Tue 4/10	Poison Pill Defense: Circon	
7	Mon 4/16	Takeover Defenses: Legal Issues	John Gorman
EXECUTIVE COMPENSATION CONTROVERSY			
8	Tue 4/17	Principles of Pay-for-Performance	
9	Mon 4/23	Backdating of Options	Prof Erik Lie
10	Tues 4/24	CEO Pay: A compensation consultant's view	Stephen F. O'Byrne
ACTIVE INSTITUTIONAL INVESTORS			
11	Mon 4/30	NBIM (Norwegian \$300 bn endowment fund)	Runa Urheim
12	Tue 5/01	Hermes (London-based pension fund)	Hege Sjo
BOARD EFFECTIVENESS AND VOTING CONTROVERSY			
13	Fri 5/04 (!)	Principles for an Effective Board	Frank Herringer
14	Mon 5/07	The value of Governance Investing	
15	Tue 5/08	Mutual Fund Governance	Meyrick Payne/ Max Rottersman
16	Mon 5/14	Naked shorts and the overvoting controversy	Jim Byrne
TERM PROJECTS			
17, 18	Tue 5/15	Project presentations (single 3hr session)	

INTERNATIONAL CORPORATE GOVERNANCE

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READINGS

The following are provided in the course packet and should be read before each class:

- Eckbo, B. Espen, 2007, **International Corporate Governance: Class Notes**, Tuck School of Business
- Misc. journal articles and one case

The following book should be read during the course (I will not assign specific chapters):

- Monks, Robert A. G. and Nell Minov, 2004, **Corporate Governance**, 3rd ed. (Blackwell) ISBN: 1405116986.

The following book is recommended – it contains a collection of good governance articles:

- Chew, Donald and Stuart L. Gillian (eds.), 2005, **Corporate Governance at the Crossroads: A Book of Readings**, (McGraw-Hill Irvin).

THE INTERNATIONAL GOVERNANCE DEBATE

Session 1: Corporate Governance and Investor Protection

- What's unique about outside investors and why do they need legal protection?
- How do different legal traditions afford investor protection?
- The controversy over corporate objectives

Eckbo – Lecture Notes: “Strong Insiders – Weak Owners”

Eckbo – Lecture Notes: “Corporate Objectives: What Should the Firm Maximize?”

Eckbo, B. Espen, “Strong Insiders Invite Weak Governance”, *Financial Times*, Mastering Corporate Governance Series, May 20, 2005.

Jensen, Michael C., 2001, “Value Maximization, Stakeholder Theory, and the Corporate Objective Function,” Pre-published Working Paper, Tuck School of Business at Dartmouth.

Blair, Margaret M, 2003, “Shareholder Value, Corporate Governance, and Corporate Performance: A Post-Enron Reassessment of the Conventional Wisdom”, in Peter K. Cornelius and Bruce Kogut (eds.), *Corporate Governance and Capital Flows in a Global Economy* (Oxford University Press), ch. 3, 53-82.

Session 2: Law and Finance: A Global Perspective

- Law and financial development
- Investor expropriation technology
- Legal families and investor rights protection

Eckbo – Lecture Notes: “Concentrated Ownership, Pyramids, and Asset Tunneling”

La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny, 2000, “Investor Protection and Corporate Governance”, *Journal of Financial Economics* 58, 3-27.
Johnson, Simon, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, 2000, “Tunneling”, *American Economic Review* 90, 22-27.

Class Visitor: Rafael La Porta, Professor of Finance at Tuck.

CONSEQUENCES OF SARBANES-OXLEY

Session 3: SOX Reforms – View from the Audit Committee

- What are key provisions of the 2002 Sarbanes-Oxley Act
- Why did we need to strengthen auditor independence?
- How severe is the risk exposure of a Director?

“The Sarbanes-Oxley Act of 2002”, Cooley Alert, August 2002, 1-11.

Class Visitor: Art Lindenauer T’59, Chairman of the Audit Committee of Schlumberger Technology Corporation

Lindenauer—class note: “Sarbanes Oxley Backlash”

Session 4 : Changing the Board: Proxy Contests

- The proxy solicitation process
- Lessons from the HP-Compaq Case
- Wealth Effects of proxy contests

Mulherin, Harold J. and Annette B. Poulsen, 1998, “Proxy Contests and Corporate Change: Implications for Shareholder Wealth,” *Journal of Financial Economics* 47, 279-313.

Class Visitor: David Drake, Georgeson Shareholder

Drake—class note: “Shareholder Voting and Proxy Contests”

Session 5: SOX, Class action, and Director Election Reforms

- Effects of SOX on the cost-benefits of public listing
- Response of foreign firms to the SOX listing requirements
- Cost-benefits of class action
- The case for director election reform

Montagnon, Peter, 2007, “The Cost to Europe of America’s Class Action Addiction”, *Financial Times*, January 5

Eckbo – Lecture Notes: “SEC and Director Election Reform”

Eckbo, B. Espen, “CEO Elections out of Shareholders’ Control”, *Financial Times*, 08/17/2004

Bebchuk, Lucian A., 2003, "The Case for Shareholder Access to the Ballot", *The Business Lawyer* 59, 1, 43-66.

Lipton, Martin and Steven A. Rosenblum, 2003, "Election Contests in the Company's Proxy: An Idea whose Time has Not Come", *The Business Lawyer* 59, 1, 67-94.

Class Visitor: Paul Danos, Dean Tuck School

HOSTILE TAKEOVERS: LEGAL AND ECONOMIC ISSUES

Session 6: Poison Pill Defense: Circon

- Defensive strategies
- Use of governance provisions
- The Circon case

Eckbo—Class Notes: "The Hostile Takeover"

Danielson, Morris and Jonathan Karpoff, 1998, "On the Uses of Corporate Governance Provisions", *Journal of Corporate Finance* 4, 347-371.

Comment, Robert and G. William Schwert, 1995, "Poison or Placebo? Evidence on the Deterrence and Wealth Effects of Modern Antitakeover Measures," *Journal of Financial Economics* 39, 3-43.

Case Study

Circon Case (HBS 9-801-403 (A), 9-801-404 (B))

Circon Case Study Questions

Each group submits a spread sheet with the numerical answer to question 4 below.

1. What motivated Circon Chairman and CEO Richard Auhll? Did he have financial incentives that strongly aligned his interests with those of the shareholders?
2. Put yourself in Auhll's shoes moments after receiving the telephone call from the U.S. Surgical CEO Leon Hirsch: how do you respond to the hostile bid? What factors would you consider? What factors should you consider (if different)?
3. Put yourself in the shoes of George Cloutier, moments after being asked by Richard Auhll to join the Circon board. Would you agree to be on the board? What role would you wish to play? Is your role consistent with your "duty of care" as member of the board?
4. If a hostile bidder had "broken through" (or triggered) the poison pill, what precisely would have happened to Circon's capital structure and the hostile bidder's stake in the company? What is the maximum cost of raising cash for (non-bidder) shareholders to be better off exercising the pill?
5. Put yourself in the shoes of Charles Elson immediately after getting elected to the Circon board. How do you assess your situation? What are your options? How do you achieve change within the board and/or within the company?
6. At the board meeting at the end of the (A) case, what options were available to the board? Which appears to have been the most attractive? How should the board have implemented this option?

Session 7: Takeover Defenses: Legal Issues

- Case precedence for use of defensive actions
- Director fiduciary duties
- Shareholder rights and the “Just Say No” defense

Class Visitor: John Gorman, Luse Lehman Gorman Pomerenk & Schick Pc
Gorman—class note: “Fiduciary Duties and the Law of Corporate Takeovers”

EXECUTIVE COMPENSATION CONTROVERSY

Session 8: Principles of Pay-for-Performance

- Principal-agent paradigm and optimal contracting
- Pros and cons of bonus systems
- Options: Accounting and repricing issues

Eckbo – Lecture Notes: “Executive Compensation”

Jensen, Michael C. and Kevin J. Murphy, 2004, “Remuneration: Where We’ve Been, How we Got to Here, What are the Problems, and How to Fix them”, Working paper, HBS and USC.

Session 9: Backdating of Options

- The backdating controversy
- Research on the extent and effects of backdating
- Governance implications of backdating

Norris, Floyd, 2007, “Option Lies May be Costly for Directors”, *The New York Times*, February 16.

Boerner, Hank, 2006, “Stay Tuned...to Time Travelers Backdating Stock Options”, *Investor Relations Update* (September), 14-17.

Heron, Randall A. and Erik Lies, 2006, “What Fraction of Stock Option Grants to Top Executives have been Backdated or Manipulated?”, working paper, University of Iowa.

Class Visitor: Erik Lie, Professor of Finance at the University of Iowa
Lie—class note: “Backdating of Option Grants”

Session 10: CEO Pay: A Compensation Consultant’s View

- Stock option valuation parameters
- Accounting expense of performance incentives
- Cost-efficiency of retention incentives

Paone, Giulia, 2006, “Executive Compensation: The SEC Proposal and the EU Recommendation”, white paper, Tuck’s Center for Corporate Governance (May)
O’Byrne, Stephen F., 2006, “Comments on SEC’s Proposed Amendments to the Disclosure Requirements for Executive Director Compensation”, Shareholder Value Advisors (April 10).
O’Byrne, Stephen F. and S. David Young, 2005, “Top Management Incentives and Corporate Performance”, *Journal of Applied Corporate Finance* 17, 105—114.

Class Visitor: Stephen O’Byrne, President, Shareholder Value Advisors, Inc.
O’Byrne—class note: “How to Identify Pay Plans that Really Make Managers Go”

ACTIVE INSTITUTIONAL INVESTORS

Session 11: NBIM (Norwegian \$300bn endowment fund)

- The Norwegian Petroleum Fund
- Governance activities of the petroleum fund
- Strategies for institutional activism

Eckbo – Lecture Notes: “Pension Fund Activism”

Letter to SEC, from group of pension funds totaling \$3.4 trillion, dated October 6, 2006, “SEC Review of AFSCME Pension Plan v. American International Group, Inc.” (4 pages)

Letter to Board of EXXON Mobil Corp, from institutional investors totaling \$850 billion, dated October 23, 2006 (2 pages)

Del Guercio, Diane and Jennifer Hawkins, 1999, “The Motivation and Impact of Pension Fund Activism”, *Journal of Financial Economics* 52, 291-340.

Class Visitor: Runa Urheim, Senior Analyst, Norges Bank Investment Management (NBIM)
Urheim—class note: “Corporate Governance: Norges Bank Investment Management”

Session 12: Hermes (London-based pension fund)

- Active governance strategies
- Cutting-edge issues in governance investing
- European governance perspectives

Becht, Marco, Julian Franks, Colin Mayer, and Stefano Rossi, 2006, “Returns to Shareholder Activism”, ECGI Finance Working Paper no. 138.

Class Visitor: Hege Sjo, Hermes

BOARD EFFECTIVENESS AND VOTING CONTROVERSY

Session 13: Principles for an Effective Board

- Why do boards fail?
- What characterizes an effective director?

- Director independence and compensation

Eckbo – Lecture Notes: “The Board”

Fuller, Joseph and Michael C. Jensen, 2002, “What’s a Director to Do?”, Pre-published working paper, The Monitor Company & Harvard Business School.

Class Visitor: Frank C. Herringer, retired CEO of Transamerica Corp, named Outstanding Director for 2004 and currently serves as lead director of the boards of Charles Schwab and Amgen."

Session 14: The Value of Governance Investing

- Avoiding expropriation: Pyramids and asset tunneling
- Empirical measures of the value of good governance
- Does “governance investing” pay as a stock trading strategy?

Eckbo-Lecture Notes: “Governance Investing”

Gompers, Paul A., Joy L. Ishi and Andrew Metrick, 2003, “Corporate Governance and Equity Prices”, *Quarterly Journal of Economics*.

Session 15: Mutual Fund Governance

- Current issues in mutual fund governance
- Do funds justify their fees?
- Fund forensics

Khorana, Ajay, Henru Servaes and Peter Tufano, 2006, “Mutual Funds Fees around the World”, working paper, Harvard Business School

Payne, Meyrick, “The Principles of Global Fund Governance”, *The Journal of Investment Compliance*, Fall 2004, Volume 5, No. 2.

Class Visitors: Meyrick Payne, Management Practice Inc., and Max Rottersmann, Fundforensics.
Payne-class note: “Mutual Fund Governance”

Session 16: Naked shorts and the overvoting controversy

- Brokerage fees and covered versus naked short selling
- The naked short controversy—resolution in sight?
- Potential impact of overvoting

Class Visitor: Jim Byrne

Package of reading material on the naked short controversy—focus on text highlighted in yellow.

Session 17-18: Student term paper presentations (single 3-hour session)