School: Harry Radzyner Law School LL.B.

Contemporary and Emerging Corporate Governance Issues

Lecturer:

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Course No.: 2838  Course Type: Elective  Weekly Hours: 1  Credit: 1

Course Requirements:

Final Paper

Language:

English

Prerequisites

Prerequisite:

4 - Legal English Advanced 2 OR 10061 - Legal English Advanced for - Honors Program

Course Description
Corporate governance is a crucial topic with growing importance in an era of hegemonic rivalry, rising economic nationalism and increasing questions about corporate purpose and responsibility. The course will explore several contemporary and emerging issues utilizing the context of several governance models thereby also providing students with an understanding and knowledge of various governance models used in different jurisdictions.

Course Goals

The course will focus on the following primary topics: 1) exploring the question of corporate purpose; 2) analyzing why corporate scandals (particularly in the financial services industry) are repeated by the same institutions; 3) evaluating whether vigorous shareholder activism is beneficial or detrimental to corporations and the wider economy (and if so, are concentrated ownership structures which limit the potential for activism inherently bad for governance); 4) discussing whether differences exist with respect to the moral hazards of bailing out SOEs in state-capitalism models versus bailing out TBTF (too big to fail) private corporations in market-capitalism models; 5) examining the impact of the U.S.-China hegemonic rivalry – will market economies be enticed to follow (or competitively pressured to) incorporate aspects of China’s state-capitalism to compete globally or will China gravitate towards a market-capitalism model?

Grading

Essay - 100%

You will have 5 weeks after the last class to send your work – May 8.

Please note that with respect to the assigned readings, you only need to read the text for our class discussions - you do not need to read the footnotes. (Of course the footnotes can serve as a basis for research if you wish)
The final exam will consist of 5 potential essays, reflecting the five different “focuses” of the course, of which you will select 1 essay question to answer. More information and the Essay questions are found below.

Exam Questions

Select any one of the following five (5) questions and draft a response. You can use whatever we discussed in class, the readings and/or other independent research relating to law and economics and current events. Do not be concerned with spelling/grammar/syntax – you will be graded on analyzing the issue and your arguments. The essay should be at least 1000 words but not more than 1500 words. You can include references (footnotes) and/or links but these do not count toward the word minimum. There is no specific font or spacing requirement although the recommended font size is 12 or 14. The essay is due 5 weeks after the last class - by May 8. Send your Essay to jslawotsky@idc.ac.il

**Essay One**: What should be the purpose of the publicly traded corporation? How does the shareholding structure (concentrated or dispersed) and the ensuing conflicts of interest impact on the question? Does the shareholder-value model and the likelihood of management-shareholder conflicts of interest affect the answer? If a corporation is not focused solely on profit-making and instead seeks to promote numerous stakeholders, how should directors/managers select an interest to promote if two or more interests exist at the same time?

**Essay Two**: What do you think is the main reason financial institutions repeatedly engage in misconduct - explain your reasons. With respect to the “revolving-door”, do you think the lure of a “big pay day” after government work discourages vigorous prosecution of corruption and may act to lessen the financial penalties (fines) imposed and what suggestions
can you offer or is the “revolving door” unsolvable? Is there a difference between jurisdictions (shareholder versus stakeholder) with respect to any of the potential reasons or is this simply human nature?

**Essay Three:** Is vigorous shareholder-activism beneficial or negative on corporations and the economy? Japan’s economic performance has been lackluster and Japan has had its share of corporate scandals. Is the lack of vigorous shareholder activism in Japan detrimental to Japanese corporations and the economy? If other nations increase governmental ownership of shares and thus create an environment whereby activism is substantially reduced (or impossible) what effects will this have on corporations and overall economic performance?

**Essay Four:** In both the United States and China, the respective governments have acted to “bail out” important corporations which may contribute to a culture of excessive risk taking since the decision makers already know (or presume) that any serious losses will be “covered” thereby creating “moral hazards”. Are moral hazards different with respect to bailing out SOEs (state-capitalism model) versus bailing out TBTF private corporations (market-capitalism model)? Different between shareholder-value or stakeholder value models? How does national security/economic nationalism affect whether a government will tolerate moral hazards?

**Essay Five:** China’s state-capitalism model (state direction, industrial policies and subsidies to SOEs) has proven a competitor to the U.S. market-capitalism model and even has some Western admirers. Will market-capitalism nations be lured to (or be competitively forced to) incorporate aspects of state-capitalism to compete with competitors who provide their corporations with subsidies and state support? Or will the opposite occur with China instituting reforms of its state-owned sectors and incorporating aspects of market-capitalism? What are likely effects of each possibility?
Course schedule:

Class One March 30

First Session 11:30-13:15

United States Shareholder Value

Issues: What should be the purpose of a publicly-traded corporation and what overriding model is best: shareholder value governance; stakeholder value; enlightened shareholder? Should the shareholding structure in the jurisdiction (concentrated or dispersed) and the ensuing conflicts of interest impact on the question? If the state is the major shareholder should that make a difference?

Background: Publicly-traded corporations in the U.S. must adhere to shareholder-value governance. Directors and officers have a legal obligation to manage the business exclusively for shareholder benefit and not to benefit other stakeholders. The rationale is based upon the fact that to encourage capital formation there must be an incentive. Since shareholders take the risk, shareholders need to receive the rewards.
Under this approach, other stakeholder interests are not taken into account unless mandated by law or risk of lawsuit. Under this model, a corporation facing adverse business conditions and experiencing lower profits will decide to terminate employees and keep the dividend rather than cut the dividend and keep employees if business conditions lead to lower profits.

What are the advantages and disadvantages of not cutting the dividend and instead terminating employees?

The United States shareholder-value model has benefits as well as alleged problems. The benefits include:

- very large and deep capital markets where raising large amounts of capital is relatively easy.

- the U.S. economy has generally been a superior performer (but see USD hegemony and a 23T USD Federal debt).

- shareholders indeed bear the risk so it is to a large degree fair that corporations are managed for their benefit.

- it is easier to focus on shareholder value as opposed to balancing other interests. How do you balance or prioritize various potentially competing interests in the stakeholder model?

Disadvantages include:

- lack of consideration of other stakeholders which may cause stakeholder loss.

- a focus on short-termism and immediate profits rather than the long-term.
-a culture of greed, many large U.S. corporations have repeatedly engaged in misconduct, fraud and criminal activity, pay a fine and move on relatively unscathed.

Goldman Sachs

https://www.youtube.com/watch?v=whlzFWwVv98

In contrast, pursuant to the stakeholder model, the corporation exists to serve the interest of numerous stakeholders and not just shareholders. This model is generally found in continental Europe. Under this model, the corporation should also consider other stakeholders such as employees, customers, communities, government, the environment, etc. when making business decisions.

There is also a middle-ground called the enlightened shareholder-value (or “sustainable capitalism”) model which essentially views shareholder-value as the ultimate interest but says other stakeholders should be considered in order to effectuate the long-term profitability of the business and creation of shareholder-value. The UK, once a shareholder-value jurisdiction, is widely considered to have incorporated this model.

Significantly, recently, some CEOs in the U.S. have called for embracing this “sustainable capitalism” model arguing that the sole focus on shareholder profits is not in the long-term interests of the business or the overall economy. https://www.nytimes.com/2019/08/19/business/business-roundtable-ceos-corporations.html

Questions: Do you believe the letter of the CEOs is a real trend or a simply a manifestation of “corporate marketing” that will not translate into any real change? If a U.S. corporation would in fact incorporate this governance.
would the directors/officers be liable for violating their duties to the
corporation and the shareholders? If you were a shareholder of a
corporation, would you want the corporate directors to make a decision
based exclusively upon your financial interests or on other interests as
well?

In the United States, generally, publicly-traded corporations have dispersed
shareholder structures as opposed to jurisdictions where shareholdings
are more concentrated. Dispersed shareholdings will often incentivize
“management-agency” conflicts of interest. Such conflicts can be divided
into three main (and sometimes overlapping) conflicts: 1) looting; 2) shirking
and 3) positional. The ability to engage in shareholder-activism (to be
discussed later in the week) may serve as a control on these conflicts.

Examples of conflicts of interest:

The Example of Simon-Worldwide Corporation

http://www.sec.gov/Archives/edgar/data/864264/000092189506001187/
0000921895-06-001187.txt

What conflicts of interest are evident in the Simon-Worldwide example?

The example of the Disney Litigation

825 A.2d 275 (Delaware 2003)
Court of Chancery of Delaware,
New Castle County.
In re THE WALT DISNEY COMPANY DERIVATIVE LITIGATION
C.A. No. 15452.
MEMORANDUM OPINION
CHANDLER, Chancellor.
The Decision to Hire Ovitz

Michael Eisner is the chief executive officer ("CEO") of the Walt Disney Company. In 1994, Eisner's second-in-command, Frank Wells, died in a helicopter crash. Two other key executives-Jeffrey Katzenberg and Richard Frank-left Disney shortly thereafter, allegedly because of Eisner's management style. Eisner began looking for a new president for Disney and chose Michael Ovitz. Ovitz was founder and head of CAA, a talent agency; he had never been an executive for a publicly owned entertainment company. He had, however, been Eisner's close friend for over twenty-five years.

Eisner decided unilaterally to hire Ovitz. On August 13, 1995, he informed three Old Board members—Stephen Bollenbach, Sanford Litvack, and Irwin Russell (Eisner's personal attorney)—of that fact. All three protested Eisner's decision to hire Ovitz. Nevertheless, Eisner persisted, sending Ovitz a letter on August 14, 1995, that set forth certain material terms of his prospective employment. Before this, neither the Old Board nor the compensation committee had ever discussed hiring Ovitz as president of Disney. No discussions or presentations were made to the compensation committee or to the Old Board regarding Ovitz's hiring as president of Walt Disney until September 26, 1995.

Ovitz's Performance as Disney's President

Ovitz began serving as president of Disney on October 1, 1995, and became a Disney director in January 1996. Ovitz's tenure as Disney's president proved unsuccessful. Ovitz was not a good second-in-command, and he and Eisner were both aware of that fact. Eisner told defendant Watson, via memorandum,
that
he (Eisner) "had made an error in judgment in who I brought into the
compny." Other company executives were reported in the December 14,
1996 edition of
the New York Times as saying that Ovitz had an excessively lavish office,
an
imperious management style, and had started a feud with NBC during his
tenure. Even Ovitz admitted, during a September 30, 1996 interview on
"Larry King
Live," that he knew "about 1% of what I need to know."

Even though admitting that he did not know his job, Ovitz studiously avoided
attempts to be educated. Eisner instructed Ovitz to meet weekly
with Disney's chief financial officer, defendant Bollenbach. The meetings
were scheduled to
occur each Monday at 2 p.m., but every week Ovitz cancelled at the last
minute. Bollenbach was quoted in a December 1996 issue of Vanity Fair as
saying that
Ovitz failed to meet with him at all, "didn't understand the duties of an
executive at a public company[,] and he didn't want to learn."

Instead of working to learn his duties as Disney's president, Ovitz began
seeking alternative employment. He consulted Eisner to ensure that no
action would be taken against him by Disney if he sought employment
elsewhere.

Eisner agreed that the best thing for Disney, Eisner, and Ovitz was for Ovitz
to gain employment elsewhere. Eisner wrote to the chairman of Sony Japan
that Ovitz could negotiate with Sony without any repercussions from Disney.
Ovitz and Sony began negotiations for Ovitz to become head of Sony's
entertainment business, but the negotiations ultimately failed. With the
possibility of
having another company absorb the cost of Ovitz’s departure now gone, Eisner and Ovitz began in earnest to discuss a non-fault termination.

Ovitz wanted to leave Disney, but could only terminate his employment if one of three events occurred: (1) he was not elected or retained as president and a director of Disney; (2) he was assigned duties materially inconsistent with his role as president; or (3) Disney reduced his annual salary or failed to grant his stock options, pay him discretionary bonuses, or make any required compensation payment. None of these three events occurred. If Ovitz resigned outright, he might have been liable to Disney for damages and would not have received the benefits of the non-fault termination. He also desired to protect his reputation when exiting from his position with Disney. Eisner agreed to help Ovitz depart Disney without sacrificing any of his benefits. Eisner and Ovitz worked together as close personal friends to have Ovitz receive a non-fault termination. Eisner stated in a letter to Ovitz that: "I agree with you that we must work together to assure a smooth transition and deal with the public relations brilliantly. I am committed to make this a win-win situation, to keep our friendship intact, to be positive, to say and write only glowing things…. Nobody ever needs to know anything other than positive things from either of us. This can all work out!"

What conflicts of interest are evident in the Disney example?

Readings:
Second Session 13:45-15:15

U.S. Corporate Governance and Repeated Corporate Misconduct

Issue: Focusing on banks and financial institutions, why do they repeatedly engage in misconduct?

Background: In the U.S., financial institutions have been repeatedly fined for engaging in a wide array of illegal conduct ranging from aiding and abetting tax evasion, sanctions evasion, interest rate rigging and other fraudulent activity. The fines imposed are substantial and often in the multi-billions of dollars. Despite the billion dollar fines, many of the institutions repeat their misconduct and engage in criminal activity and again pay fines and continue operating.

Evidently, these corporations are so important to financial stability that they are “too big to fail”. This may encourage corporations to take excessive risks knowing in advance that whatever punishment is meted out will not be severe enough to make a meaningful difference because these corporations
are too important. This brings a “moral hazards” problem because knowing in advance that the corporation will be “bailed out” means there is little incentive not to engage in wrongdoing.

Additional factors other than “TBTF” are likely at play as well:

- profits may dwarf the fines
- no jail
- revolving door

Questions: What is the most important factor causing serial misconduct? What can be done – if anything?

Readings:

Joel Slawotsky, Reining in Recidivist Financial Institutions
http://www.djcl.org/2015---volume-40---number-1-5
pp 282-316 text only (no need to read footnotes).


https://archives.cjr.org/the_audit/the_revolving_door_spins_for_r.php

https://www.forbes.com/sites/harveysilverglate/2011/06/22/revolving-door/#6474e655bf9c
class Two Wednesday April 1 2020
First Session 17:30-19:00

Japan’s Insider Stakeholder Model

Issue: Is the ability to engage in vigorous shareholder activism positive for corporate governance and the economy or are the benefits outweighed by negatives?

Background: Most measures of Japanese economic activity have been lackluster for roughly 25-30 years including GDP, deflation and stock market performance. Japanese economic malaise has been caused at least in part (if not largely by) poor corporate governance.

Japan’s Nikkei Index

Olympus Scandal

https://www.youtube.com/watch?v=6EY1CTbO7Uo

PM Abe has admitted that poor governance is holding back Japan’s economy. Japan’s governance is characterized by a board dominated by insiders who are fiercely loyal internally, a lack of independent directors, and a diminishing yet still existing web of inter-locking ownership known as Keiretsu. While Japan’s governance is “stakeholder” essentially the only real stakeholders are insider directors/officers. Japan has also had a series
of high profile accounting scandals at large corporations including: Olympus, Toshiba and Nissan. Japan’s shareholding structures and overall governance present significant hurdles for shareholder activists.

“Japan’s traditional system of corporate governance based on keiretsu networks of cross-shareholdings, bank-centered finance, and life-long employment has attracted significant scholarly attention. Insulated from foreign influence, levels of foreign direct investment (FDI) in the country are extraordinarily low, and so is the incidence of foreign acquisitions. Remarkably, Japan is the only developed economy that has yet to witness its first successful hostile takeover in the postwar era.”(Maria Pargendler, The Grip of Nationalism on Corporate Law, https://law-economic-studies.law.columbia.edu/sites/default/files/content/docs/Pargendler,%20The%20Grip%20of%20Nationalism%20on%20Corporate%20Law%20-%20ECGI.pdf page 22)

Questions: Is the extreme difficulty of taking over a large Japanese corporation and engaging in vigorous shareholder activism a proximate cause of Japan’s economic performance? Are there solutions?

Readings:


Session Two 19:30-20:45

China’s State-Capitalism Model
Issue: Do differences exist with respect to the moral hazards of bailing out State Owned Enterprises (“SOE”) versus bailing out TBTF (too big to fail) private corporations?

Background: China’s governance is based upon state-capitalism whereby the state is significantly involved in directing economic sectors and holds positions in strategic and important corporations - state-owned enterprises (“SOEs”). Globally, SOEs are considered less efficiently run than private enterprises and subject to corruption. The corruption and inefficiency problem is endemic to state-owned businesses.

“Petrobras as an exemplar of corruption issues in SOEs”. “[S]upplier firms and operators in the Petrobras drilling process ‘coincidentally’ have as shareholders some of the same construction and contractor enterprises.”

Maria Lima and Paulo Clarindo Goldschmidt, ‘Corruption and Brazilian Crisis: the Case of Petrobras’ in Maria Lima and José Ghirardi (eds) Global Law: Legal Answers for Concrete Challenges (Juruá Editora 2018) 109 and 122.


China also practices economic nationalism by promoting state champions (i.e., Huawei) and favoring them over foreign competitors. Huawei Example - https://www.wsj.com/articles/state-support-helped-fuel-huaweis-global-rise-11577280736

China’s model has been successful, propelling China into an economic giant with the second largest nominal GDP. However, one important developing issue (a second will be the focus tomorrow) is the extent by which China will bail out SOEs if the business needs help to survive. Until fairly recently, China has indeed stepped in to prevent SOEs from collapsing.
In the United States, government bailouts are not in accordance with the market-capitalism model pursuant to which, the corporation would be left on its own to either survive and recover or fail and go bankrupt. Yet the U.S. just a decade ago also bailed out some major U.S. private corporations such as AIG (insurance); Citigroup (bank); and auto companies. The rationale was that these entities were simply TBTF and would cause serious damage to the U.S. economy if left to fail.

Question: The problem of “moral hazard” - knowing a bailout will be forthcoming - may encourage unreasonable risk taking or the lack of effective oversight by directors and managers. Is there a difference between the moral hazard question between state-capitalism and market-capitalism?

Reading:

Joel Slawotsky, The National Security Exception in US-China FDI and Trade: Lessons from Delaware Corporate Law https://academic.oup.com/cjcl/article/6/2/228/5265145?searchresult=1 Click on PDF - pages 239-249 - The reading provides a context and perspective on the US-China rivalry that will also be the focus for the last class but should be read in advance.

Another reading is an excerpt from an upcoming book-chapter. This book chapter is relevant to both Classes 2 and 3. The excerpt is distributed as a separate attachment.

Class Three April 3, 2020

First Session 8:45-10:15

U.S. Market-Capitalism vs China’s State-Capitalism Model: Will One Model Incorporate Aspects of the Other Model?

Issue: What will be the impact of the U.S.-China hegemonic rivalry on other nations; will market economies be forced to incorporate aspects of China’s state-capitalism to compete globally or will the opposite occur?
A hegemonic rivalry is underway between the U.S. and China for global dominance in the pillars of hegemonic power: military, economic and technological strength. China’s state-capitalism model is fundamentally different than the U.S. market-capitalism economic governance architecture. While the U.S. has fluctuated depending upon political party over more or less government regulation, in general, the mantra of both major parties is to have less governmental interference in the economy. Market-capitalism based business decisions on based upon profit not national strategic objectives.

China’s state-capitalism encourages businesses to earn a profit but also involves state intervention for favored sectors or specific corporations. Preferential treatment, low cost loans from state-owned banks, subsidies and discouraging/preventing foreign competition are part of China’s state-capitalism.

The rivalry is leading to a variety of impacts such as Western nations tightening review of foreign investment, sovereigns considering buying shares defensively to protect “national champions” and a general shift towards is increasing economic nationalism. Some Western nations admire China’s industrial policies which are viewed as successful and advocate for replicating those policies.


Michelle Martin, Paul Carrel and Reinhard Becker, ‘Germany ready to buy stakes in automakers, other companies to protect them’ (Autoblog, 5 February 2019) https://www.autoblog.com/2019/02/05/germany-buy-stakes-automakers-protection/ (state considering acquiring shares to prevent a foreign government from controlling corporation).
Questions: Will the United States market-capitalism model (in the U.S. and in other Western market-capitalist economies) incorporate aspects of state-capitalism either to imitate perceived Chinese success or out of competitive pressure (or to defend national economic and industrial strength)? Or will the opposite occur and will China in fact incorporate aspects of market-capitalism?

Readings: Excerpt from upcoming book chapter – this is the reading referenced in Class 2 above and is relevant to both Classes 2 and 3. It is a separate attachment.

Session Two
Review and Exam Preparation 10:45-12:00

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Reading List

**Class One March 30**

**First Session 11:30-13:15**

Readings:


https://repository.uchastings.edu/hastings_business_law_journal/vol12/iss3/4/ pp 542-547
Second Session 13:45-15:15

Readings:

Joel Slawotsky, Reining in Recidivist Financial Institutions
http://www.djcl.org/2015--volume-40--number-1-5
pp 282-316 text only (no need to read footnotes).


https://archives.cjr.org/the_audit/the_revolving_door_spins_for_r.php

https://www.forbes.com/sites/harveysilverglate/2011/06/22/revolving-door/#6474e655bf9c
https://dealbook.nytimes.com/2013/03/28/once-more-through-the-revolving-door-for-justices-breuer/

Class Two Wednesday April 1 2020

First Session 17:30-19:00

Readings:

https://repository.uchastings.edu/hastings_business_law_journal/vol12/iss3/4/ pages 551-563

Session Two 19:30-20:45

Reading:

Joel Slawotsky, The National Security Exception in US-China FDI and Trade: Lessons from Delaware Corporate Law https://academic.oup.com/cjcl/article/6/2/228/5265145?searchresult=1 Click on PDF - pages 239-249 - The reading provides a context and perspective on the US-China rivalry that will also be the focus for the last class but should be read in advance.

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