New York University
Leonard N. Stern School of Business

A History of Scandal: The Evolution of Corporate Governance
B65.2177
Dates: Nov. 6 – Dec. 18, 2007; Tuesdays 6pm – 9pm
Classroom: KMC3-60

Instructor Marc Hodak

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Course description:

This course examines the role of scandals in prompting corporate reforms and
government regulation intended to improve the practice of corporate governance. We
will explore how the response to scandal comprises both market (economic) and non-
market (social, political, legal) components. We will employ this distinction to better
understand how these responses work with - or against - each other to affect corporate
governance and prevent subsequent market crises. Our cases will include some of the
most notorious business scandals in U. S. history, and the governance policy changes
they prompted, including:

* How the 19th Century's Credit Mobilier affair led to the rise of both railroad
  regulation and investment banking
* How diabolically clever stock machinations at the Erie Railroad—"The Scarlet
  Woman of Wall Street"—helped make the NYSE the most sophisticated stock
  exchange in the world
* The strange, amazing story of Ivar Kreuger, and how it enabled passage of the
  Securities Acts of 1933 and 1934
* How Enron, WorldCom, and the DotCom/Telecom crash led to Sarbanes-Oxley,
  and its discontents

We will contrast prescriptions for improving transparency and incentives with those that
constrain managerial and investor action, and assess their effects on corporate
governance and capital markets.

Method of instruction

Classes will rely primarily on lecture and cases with a mixture of historical, financial, and
legal facts. We will also have occasional guest lecturers to complement the readings.
Students will be required to prepare for classes, attend, and participate in discussions
around the lectures and readings. There will also be certain cases requiring students to
interact with each other in various roles under certain rules. Scandals invite controversy,
and students will not be spared from offering their considered views on historical events
or their echoes in current news.
Readings

Preparatory readings are assigned for each class. All readings will be located on either this class’s Blackboard page or a Xan edu course pack, which must be purchased. On the class Blackboard page, you will find a copy of this syllabus and various reading. On Xan edu.com you will find additional required readings. To access these readings, you will need to purchase a Xan edu access code from the NYU Professional Bookstore.

How to access your Xan edu Course Pack:

1. Open a Web browser and go to www.xan edu.com.
2. ALREADY A REGISTERED XAN EDU USER?
   Log in to go to your My Xan edu page. At the bottom of your My Xan edu page is a field labeled ‘Do you have a key for a Course Pack or ReSearch Engine?’ Enter the 16-digit key shown below, including the hyphens, into this field and click ‘Go’.
3. NOT A REGISTERED XAN EDU USER?
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Important things to know about the key and your digital Course Pack

- You can enter the numeric key shown above only one time. If you have a problem or question, call Xan edu Customer Service at 800-218-5971, Option 3, or send email to contact@xan edu.com.
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- You will have unlimited access to your digital Course Pack until whichever comes first:
  six months after the date of purchase,
  Or two months after the last day of your course (as specified by your instructor).
- To access your Course Pack at anytime:
  1. Open a Web browser and go to www.xan edu.com.
  2. Log in with your user name/password combination.
  3. Select the Course Pack from the My Course Packs list on your My Xan edu page.
  4. Click ‘Go’.

Please let me know as soon as possible if you have any problems accessing the course pack.

Grading

Class participation:  20%
Report, presentation, quizzes:  40%
Final exam:  40%
Course schedule and readings:

1. Defining scandal and response: Agency costs gone wild Nov. 6
   
   Topics:
   - The problem of agency: separation of ownership and management
   - Evolved mechanisms for containing agency costs
   - Elements of scandal: Betrayal, politics and the media
   - Case: Credit Mobilier and the Union Pacific (1872)
   - Cures: Investment banking and railroad regulation

   Readings:
   - Selections from “The Railroad System” by Charles F. Adams, Jr. (1871)

2. Dominant shareholder self-dealing: Sleeping with an elephant Nov. 13
   
   Topics:
   - Related-party transactions, squeeze-outs, greenmail, and other abuses
   - Scandals: The Erie War (1867-1868); Dodge v. Ford (1916)
   - Responses: Blue Sky laws; “shareholder primacy”

   Guest: John Steele Gordon - acclaimed business historian; author of seven books

   Readings:

3. Managerial self-dealing: What the shareholders don’t know… Nov. 27
   
   Topics:
   - Disclosure: The problems of asymmetrical information
   - Corrupt management in different flavors
   - Cases: Insull’s empire (1932); Kreuger & Toll (1932)
   - Cures: Rise of professional SROs; Securities Acts of 1933 and 1934

   Readings:
4. Managerial entrenchment: Corporate raiders, corporate saviors  Dec. 4

Topics:
- Agency costs and benefits of managerial power
- Conglomerates: Getting bigger instead of better?
- Financial engineering: Blurring the distinction between debt and equity
- Cases: Milken, the “Junk Bond King” (1975-'89); The Keating 5 ('89)
- Cures: Williams Act; LBOs and the rise of “corporate raiders”

Readings:
- Greenwald, John, “Predator’s Fall,” *Time*, February 26, 1990
- “The Mythology of Mike Milken,” (Milken Institute)

5. Perverse incentives I: Paying managers to fail  Dec. 11

Topics:
- Poor incentives as cause or effect of governance failure
- Illusory and unobservable behavior: When directors can’t judge the bets

Guest: Prof. Larry Ribstein – prominent legal scholar; Mildred Van Voorhis Jones Chair in Law, University of Illinois

Readings:

6. Perverse incentives II: Failure of the gatekeepers  Dec. 18

Topics:
- Roles and incentives: Directors, lawyers, auditors, analysts, journalists
- Scandal: Enron (cont.)
- Responses: Redefined expectations of boards and investors; Sarbanes-Oxley; “Global Settlement”
- Discussion of Final Exam

Readings: