

AEI/BROOKINGS PRESENTATION
APRIL 20, 2007

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Different Issues Concerning Shareholder Rights

- Takeover Defenses
- Majority Voting
- Shareholder Access to the Proxy
- Executive Compensation
- Arbitration of securities actions

Takeover Defenses

Simple Fact

Never has been a successful takeover with poison pill in place

Importance of Staggered Board

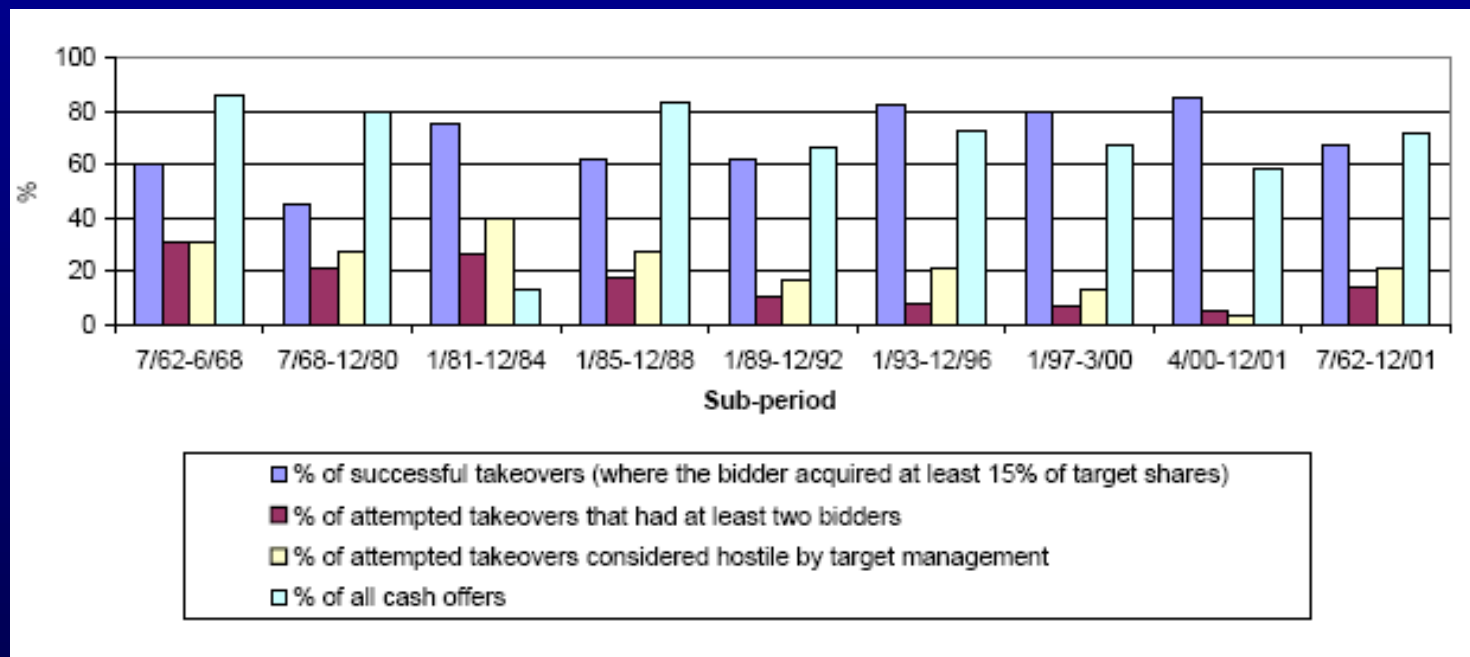
Takes two election cycles to replace the board

Theoretical Problems

- Ex ante Agency Problems
- Ex Post Agency Problems

Decline of the hostile takeover

(Bhagat, Dong, Hirschleifer and Noah 2005)



Importance of the Takeover Market (Berger and Ofek JOF, 1996)

Panel A: Sample Takeover/LBO Frequencies for the Total Sample and the 1984 and 1987 Base Years

	Total	1984	1987
Number of firms	1513	1192	1085
Takeovers	334	251	127
Takeover Frequency	22%	21%	12%
LBOs	47	28	25
LBO Frequency	3%	2%	2%

Panel B: Takeovers and LBOs by Year of Announcement

Fiscal Year Announced	Takeovers	LBOs
1985	61	5
1986	63	6
1987	62	9
1988	80	15
1989	44	11
1990	17	1
1991	7	0
Total	334	47

U.S. Corporate Law

- *Pre-1990 case law*
- *Paramount v. Time*
- *Widescale presence of staggered boards*

A Point of Comparison

- General Principle 3 of the City Code on Takeovers and Mergers:

A target board “must not deny holders of securities the opportunity to decide on the merits of the bid” made by an acquirer

- City Code Rule 21

Cannot adopt a poison pill without shareholder approval

- Companies Act of 1985

Statutory right to remove directors at any time

“What Matters in Corporate Governance”

TABLE I: INCIDENCE OF CORPORATE GOVERNANCE PROVISIONS

	YEAR					
	1990	1993	1995	1998	2000	2002
Entrenchment Index Provisions:						
Staggered Board	59.2%	60.5%	61.8%	59.5%	60.5%	61.9%
Limits to Amend Bylaws	14.5%	16.2%	16.1%	18.2%	20.0%	23.2%
Limits to Amend Charter	3.3%	3.4%	3.1%	3.0%	3.3%	2.5%
Supermajority	39.0%	39.5%	38.4%	34.1%	34.1%	32.3%
Golden Parachutes	53.3%	55.7%	55.2%	56.9%	67.4%	70.2%
Poison Pill	54.4%	57.6%	56.6%	55.4%	59.9%	59.0%
All Other Provisions:						
Limits to Special Meeting	24.8%	30.0%	32.0%	34.8%	38.3%	50.2%
Limits to Written Consent	24.8%	29.3%	32.1%	33.3%	36.2%	46.4%
No Cumulative Vote	81.6%	83.6%	85.0%	87.8%	89.0%	90.4%
No Secret Ballot	97.1%	90.5%	87.8%	90.4%	89.1%	88.8%
Director Indemnification	40.8%	39.5%	38.5%	24.5%	23.6%	19.1%
Director Indemnification Contracts	16.6%	15.2%	12.6%	11.2%	9.1%	8.1%
Director Liability	72.7%	69.2%	65.5%	47.2%	43.1%	33.9%
Compensation Plans	45.3%	66.1%	72.8%	63.2%	72.6%	74.0%
Severance Agreements	13.1%	5.5%	10.2%	11.2%	9.2%	6.1%
Unequal Vote	2.4%	2.0%	1.9%	1.7%	1.5%	1.6%
Blank Check	76.7%	80.1%	85.9%	88.0%	89.4%	90.8%
Fair Price	58.0%	59.1%	57.6%	49.4%	48.5%	44.0%
Cash Out Law	4.1%	3.7%	3.6%	3.1%	2.7%	2.5%
Director Duties	10.4%	11.1%	10.9%	9.9%	10.2%	10.8%
Business Combination Law	84.1%	87.5%	87.4%	88.4%	89.0%	89.1%
Anti-green Mail	19.7%	20.8%	20.1%	17.1%	15.8%	15.0%
Pension Parachutes	4.0%	5.3%	4.0%	2.2%	1.5%	1.0%
Silver Parachutes	4.1%	4.9%	3.5%	2.4%	2.0%	1.7%

TABLE VII: THE ENTRENCHMENT INDEX AND FIRM VALUE

This table reports pooled OLS regressions of log (industry-adjusted Tobin's q) on various controls and different specifications of the entrenchment index. Tobin's q is the ratio of the market value of assets to the book value of assets, where the market value of assets is computed as book value of assets plus the market value of common stock less the sum of book value of common stock and balance sheet deferred taxes. Industry-adjusted Tobin's q is equal to Tobin's q minus the median Tobin's q in the industry, where industry is defined by two-digit SIC code. Entrenchment index i ($i=1, 2, 3, 4,$ and $5-6$) is equal to 1 if the firm has an entrenchment level i and 0 otherwise. Other Provisions Index is equal to the GIM index (Gompers-Ishii-Metrick (2003)) minus the entrenchment index. Insider Ownership is equal to the fraction of shares held by officers and director. ROA is the ratio of net income to assets. CAPEX/assets is the ratio of capital expenditures to assets. R&D per Sales is the ratio of research and development expenditures to total sales. Leverage is the ratio of long-term debt plus debt due in one year to assets. Year dummies and a dummy for missing R&D data are included in all regressions, but their coefficients (as well as the constant) are omitted. Columns 1 and 2 provide OLS estimates, which are White (1980) robust, and columns 3 and 4 provide the results of regressions with fixed firm effects. Robust standards errors appear below the coefficient estimate. Significance levels are indicated by *, **, and *** for 10%, 5%, and 1% respectively.

Variable	(1)	(2)	(3)	(4)
Entrenchment Index E	-0.044*** 0.004		-0.020*** 0.007	
Entrenchment Index 1		-0.092*** 0.023		-0.056** 0.022
Entrenchment Index 2		-0.146*** 0.022		-0.065*** 0.025
Entrenchment Index 3		-0.155*** 0.022		-0.077*** 0.029
Entrenchment Index 4		-0.206** 0.023		-0.104*** 0.031
Entrenchment Index 5-6		-0.282*** 0.027		-0.107*** 0.040
Other Provisions Index	0.010*** 0.003	0.010*** 0.003	0.002 0.006	0.002 0.006
Log(Assets)	0.015*** 0.004	0.015*** 0.004	-0.119*** 0.014	-0.118*** 0.014
Log(Company Age)	-0.048*** 0.008	-0.047*** 0.008	-0.026 0.031	-0.026 0.031
Delaware Incorporation	-0.03*** 0.01	-0.028*** 0.01	0.004 0.04	0.008 0.04
Insider Ownership	0.001 0.001	0.001 0.001	0.005*** 0.002	0.005** 0.002
Insider Ownership Square	-0.00003 0	-0.0003 0	-0.0001* 0	-0.0001* 0
ROA	0.008 0.009	0.008 0.009	0.019 0.015	0.019 0.015
CAPEX / Assets	0.994*** 0.089	1.00*** 0.09	0.868*** 0.120	0.869*** 0.120
Leverage	-0.544*** 0.046	-0.553*** 0.046	-0.426*** 0.047	-0.427*** 0.047
R&D per Sales	0.002** 0.001	0.001* 0.001	-0.001** 0.001	-0.001** 0.001

TABLE IX
THE ENTRENCHMENT INDEX PROVISIONS AND FIRM VALUE

This table reports the results of 24 pooled OLS regressions of log (industry-adjusted Tobin's q) on provisions in the entrenchment index and various controls. Each column displays the results of four different regressions investigating a given provision, and it displays only the coefficient of the provision of interest in these four regressions. The independent variables other than governance provisions are the same as in the regressions of table VII. OLS estimates are White (1980) robust. Robust standards errors appear immediately below the coefficient estimate. Levels of significance are indicated by *, **, and *** for 10%, 5%, and 1% respectively.

	Staggered Board	Golden Parachutes	Limits to Amend Bylaws	Limits to Amend Charter	Supermajority	Poison Pill
Coefficient in a regression with (i) the provision, and (ii) the GIM index minus the provision.	-0.035*** 0.011	-0.024** 0.012	-0.079*** 0.022	-0.048*** 0.01	-0.079*** 0.0101	-0.061*** 0.011
Coefficient in a regression with (i) the provision, (ii) the Entrenchment index minus the provision, and (iii) the Index of All Other Provisions.	-0.051*** 0.005	-0.037*** 0.005	-0.047*** 0.004	-0.044*** 0.004	-0.045*** 0.005	-0.042*** 0.005
Coefficient in a regression with (i) the provision, (ii) dummies for each of the other five provisions in the Entrenchment Index, and (iii) the Index of All Other Provisions.	-0.026** 0.011	-0.025** 0.012	-0.067*** 0.021	-0.044*** 0.01	-0.07*** 0.011	-0.046*** 0.011
Coefficient in a regression with (i) the provision, (ii) dummies for each of the other twenty-three IRRC provisions.	-0.030*** 0.011	-0.026** 0.012	-0.068*** 0.022	-0.043*** 0.01	-0.071*** 0.011	-0.048*** 0.011

Some additional studies

Faleye (2006)

negative announcement returns on adoption of classified boards (n=159)

Forced turnover for poor performance much lower

Pay for performance much less sensitive

Bebchuk, Coates and Subramanian (2002)

hostile targets far more likely to remain independent

Swartz (1998)

Market reaction (-16%) to Massachusetts' 1990 mandatory classified board statute

Jarrell and Paulson (1987)

negative announcement returns on adoption of classified boards (n=28)

Committee Recommendation

Classified boards of U.S. companies should be required to obtain shareholder authorization prior to the adoption of a poison pill

If the company is the target of a takeover, the board may adopt a poison pill unilaterally, but must receive shareholder ratification with three months.

Resolution of disputes between shareholders and companies

- Shareholders are the residual claimants so they arguably have the proper incentives
- Post-IPO vote
- Issues concerning how arbitration would be structured

Shareholder Access to the Proxy

- Majority Voting
- Broker discretionary voting
- Falling costs of voting

Electronic proxy delivery

Executive Compensation

- New disclosure requirements
- Stock option expensing
- Compensation process requirements