



## CORPORATE FINANCE LAW (LL301)

**Course duration:** 54 hours lecture and class time (Over three weeks)

**Summer School Programme Area:** Law

**LSE Teaching Department:** Department of Law

**Lead Faculty:** Edmund Schuster (LSE) and Carsten Gerner-Beuerle (UCL)

**Pre-requisites:** Some familiarity with company law (any jurisdiction) is an advantage. Students with no previous exposure to company law may find it useful to first take [LL135 Introduction to Corporate Law and Governance](#) in Session One.

### Course Introduction:

In this module we will analyse the legal aspects of corporate finance. There are three primary components of this module. The first component is an introduction to corporate finance theory, which covers the nature of equity and debt as well as an introduction to theories of capital structure and valuation. The second part of the module covers the nature and regulation of legal capital, including minimum capital and the regulation of dividends and share buy-backs. The third part of the module addresses the issuance of debt and equity, related aspects of securities regulation, such as insider trading and disclosure regulation, as well as mergers & acquisitions.

The module's primary focus is on UK and EU law and regulation. However, the module will also draw on the approaches to regulation in other jurisdictions, such as the United States and Germany.

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**Lectures:** 36 hours **Classes:** 18 hours

**Assessment:** Written work and one written examination

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### Teaching method and preparation for class:

In order to prepare for each lecture, students should study the core readings in advance. Students are expected to come to classes prepared to discuss the readings. The articles and book chapters listed under optional readings are intended to give students an opportunity to follow up on certain issues of particular interest and obtain a deeper understanding of the topics discussed in class. They may also serve as a starting point for further research, but they do not need to be read as preparation for the class.

### Course text:

The course is not taught on the basis of a single recommended textbook. Rather, for each seminar, we will assign a number of articles, book chapters, and court decisions as readings and also make available handouts with additional information and questions for discussion.

### Course overview:

The course will be taught in twelve seminars of 3 hours each.

- Session 1: Introduction
- Sessions 2: Capital structure, risk and return
- Session 3: Limited liability, its effects, and legal remedies
- Session 4: Initial legal capital and dividends
- Session 5: Liability, disguised distributions and capital reductions
- Session 6: Share buy-backs and financial assistance
- Session 7: Issuing equity and debt I
- Session 8: Issuing equity and debt II
- Session 9: Issuing debt and equity III
- Session 10: Market abuse regulation
- Session 11: Takeovers, mergers, and corporate restructuring
- Session 12: Regulatory competition / conclusion

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### Assessments:

#### Formative assessment

This assessment will not count towards the overall grade, but will help prepare students for the summative assessments. There will be an online quiz (on Moodle) due on Friday 3<sup>rd</sup> August, with feedback on Monday 6<sup>th</sup> August.

#### Summative Assessments

An essay worth 40% of your overall grade will be due on Thursday 10<sup>th</sup> August, grades and feedback will be given on Monday 13<sup>th</sup> August.

A final examination worth 60% of the final overall grade will take place on Friday 17<sup>th</sup> August. The precise time and location of the exam will be circulated during the programme. Final overall grades will be released within a week of the final exam.

## DETAILED SYLLABUS

### 1. Introduction

In the first session of our course, we will outline the subject area covered by the course and put it into the wider context of financial markets, capital markets law, and corporate law. Students will also be introduced to some of the basic accounting principles necessary to understand the purpose and functioning of balance sheets. Other foundational concepts, such as time value of money, relevance and calculation of net present values, and valuation of equity will also be covered.

#### Core Readings:

R.A. Brealey, S.C. Myers and F. Allen, Principles of Corporate Finance (2014): chapter 2

### 2. Corporate Finance Theory I

In the second lecture, we will discuss the relationship between debt and equity from both a financial and a legal perspective. We will explore possible drivers for capital structure decisions taken by corporations, and the corporate governance aspects of the choice between equity and debt. Students will also be provided with a non-technical introduction to the Capital Asset Pricing Model, which we will serve as a starting point for an exploration of the trade-offs between risk and return on capital markets.

#### Core Readings:

\*\* E Ferran and LC Ho, Principles of Corporate Finance Law (2014), Chapter 3 “Capital Structure”

\*R.A. Brealey, S.C. Myers and F. Allen, Principles of Corporate Finance (2014): chapters 7, 8, and 17

### 3. Corporate Finance Theory II

Building on the concepts discussed in the second lecture, the third lecture will look at the effects of limited liability afforded to shareholders of corporations, the use and abuse of the corporate form, and legal strategies to address resulting problems in both UK and EU law. This will include a discussion of “veil piercing” as well as groups of companies. We will also explore the interrelationship between insolvency and corporate law will in this context.

#### Core Readings:

\*\* E Ferran and LC Ho, Principles of Corporate Finance Law (2014), Chapter 2

\*R.A. Brealey, S.C. Myers and F. Allen, Principles of Corporate Finance (2014): chapter 18

\* Davies, P., 2006. Directors' creditor-regarding duties in respect of trading decisions taken in the vicinity of insolvency. European Business Organization Law Review, 7(01), pp.301-337

#### **4+5. Legal capital and dividends**

In lectures four and five, we will look at the legal rules determining the initial legal capital of companies. The main aim of lecture four is for students to develop a conceptual understanding of the “legal capital” framework which forms the basis rules concerning dividend pay-outs and other corporate distributions in all EU countries. We will discuss the rationales for, and the arguments against, requiring a minimum capital, and examine the types of distributions companies can make to their shareholders. We will also look at the company law requirements for making distributions under UK law, and discuss the reform discussions surrounding this area of law.

Building on our understanding of the legal capital system, we will then explore the rules governing the liability for unlawful and disguised distributions to shareholders, as well as the law relating to capital reductions.

#### **Core Readings:**

**\*\*D. Kershaw, *Company Law in Context: Text and Materials* (2012): Chapter 19 pp 812 - 845 [for lecture 4] and pp 846 – 876 [for lecture 5]**

L. Gullifer and J. Payne, *Corporate Finance Law, Principles and Policy* (2nd ed), pp 146 – 162

**\*J. Armour, ‘Legal Capital: An Outdated Concept?’ (2006) 7 *European Business Organisation Law Review* 5**

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#### **Further readings (not required):**

D. Kershaw, ‘Involuntary Creditors and the Case for Accounting Based Distribution Regulation’ (2009) 2 *Journal of Business Law* 140

W Schoen, "Comment: Balance Sheet Tests or Solvency Tests - or Both", (2006) 7 *European Business Organization Law Review* 181 (Moodle)

J Rickford (ed.), "Reforming Capital: Report of the Interdisciplinary Group on Capital Maintenance", (2004) 15:4 *European Business Law Review* 919, ch 1,2,5 and Annex C (Moodle)

Position of the Internal Market Directorate and Services on Further Reform of the Second Directive

ICAEW, *Guidance on the Determination of Realised Profits*

KPMG, *Feasibility Study on an alternative to the capital maintenance regime* (2008)

#### **6. Share Buy-Backs and Financial Assistance**

In lecture six, we will look at share buy-backs and redemptions. Share buy-backs are a very popular, and somewhat controversial, way of returning capital to shareholders. We will discuss the function of share buy-backs and, utilising our understanding of the legal capital regime, we will analyse the company law rules

governing share buy-backs and redemptions in the UK and in other EU member states. We will also examine the constraints company law puts on financial assistance and the relevance of these rules in the UK.

### Core Readings:

- \*\*D. Kershaw, *Company Law in Context: Text and Materials* (2012): Chapter 17 pp 742 – 768
- \* L. Gullifer and J. Payne, *Corporate Finance Law, Principles and Policy* (2nd ed), Chapter 10

### Further readings (not required):

- \*\* City of London Law Society, *The Implications for Leveraged Transactions of the Repeal of the Statutory Prohibition of Financial Assistance by Private Companies* (2008) (CP and Moodle)
- \* John Lowry, 'The prohibition against financial assistance: constructing a rational purpose' in Prentice and Reisberg (eds) *Corporate and Financial Law in the UK and EU* (OUP 2011) 3 (CP)
- \* *Chaston v SWP Group plc* [2003] 1 BCLC 675, CA (CP)
- \* *ParOS plc v Worldlink Group Plc* [2012] EWHC 394 [59]-[73] (CP)

## 7. Issuing Debt and Equity: Corporate Law Requirements

In lectures 7-9, we will look at how companies issue shares and bonds to the investing public. We will start by exploring, in lecture 7, the company law aspects, such as directors' authority to issue and allot shares, shareholder voting in relation to capital increases, pre-emption rights, and rules governing the payment for shares. The relevant EU law rules will also be discussed in this context, and we will look at the solutions employed by other jurisdictions to deepen our understanding of the available regulatory approaches.

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### Core Readings:

- \*\*D. Kershaw, *Company Law in Context: Text and Materials* (2012): Chapter 17 pp 716-734
- \*\*A. Cahn and D.C. Donald, *Comparative Company Law* (2009): Chapter 5 II and chapter 6 (except section on UK law)
- \*E. Ferran and Look Chan Ho, *Principles of Corporate Finance* (2014): chapters 5 and 11

### Further readings (not required):

- P.L. Davies and S. Worthington, *Gower & Davies' Principles of Modern Company Law* (2012), chapter 24
- \*\*Case C-42/95 *Siemens AG v Nold* [1996] ECR I-6017
- \*\*Second Company Law Directive (Directive 2012/30/EU), Articles 29-33 (Moodle)
- \*\*German Stock Corporation Act, §§ 182-186 (Moodle)

## 8. Issuing Debt and Equity: Regulatory requirements

In lecture 8, we will look at some of the regulatory aspects of issuing securities. In this lecture, we will look at the rules regarding the public offering of securities, including the regulation of prospectuses. We will also discuss the rationales for mandatory disclosure and the link between disclosure and the efficient capital markets hypothesis.

### Core Readings:

\*\*E. Ferran and Look Chan Ho, *Principles of Corporate Finance* (2014): chapter 13 pp 351-388 and chapter 14 pp 431-446

\*\*Prospectus Regulation (Regulation (EU) 2017/1129), Articles 3-24 (Moodle)

*For comparison with the US:*

Securities Act 1933, ss 2(a)(3), (10), 4, 5-7, Securities Act Rules 144A (17 CFR § 230.144A), 176 (17 CFR § 230.176) (available on Moodle)

### Further readings (not required):

R.J. Gilson & R. Kraakman, *The Mechanisms of Market Efficiency*, 70 Va. L. Rev. 549 (1984) (CP)

\*\*R.A. Brealey, S.C. Myers and F. Allen, *Principles of Corporate Finance*: chapter 13

Gilson and Kraakman, 'The Mechanisms of Market Efficiency Twenty Years Later: The Hind-sight Bias.' Columbia Law and Economics Working Paper No. 240, available at SSRN:

<http://ssrn.com/abstract=462786>

Coffee, 'Market Failure and the Economic Case for a Mandatory Disclosure System' 70 Virginia Law Review 717 (1984)

B. Black, 'Behavioral Economics and Investor Protection: Reasonable Investors, Efficient Markets' 44 Loy. U. Chi. L.J. 1493 (2012-2013)

R. Veil, *European Capital Markets Law*, § 16 and § 17 I-III

## 9. Issuing Debt and Equity: Liability for incorrect disclosures

In lecture 9, we will explore the mechanisms of public and private enforcement of securities regulation. We will look at gatekeeper theory, and we will analyse the liability for misstatements in public offering prospectuses under UK and US law.

### Core Readings:

\*\*E. Ferran and Look Chan Ho, *Principles of Corporate Finance* (2014): chapter 13 pp 388-406

- \*\*Handout with summary of US case law (Moodle)
- \*\*FSMA s 90 and sch 10 (link on Moodle)
- \*\*Prospectus Rules, PR 5.5.3 (link on Moodle)

#### Further readings (not required):

- P.L. Davies, 'Liability for Misstatements to the Market: Some Reflections', 9 Journal of Corporate Law Studies 295 (2009)
- R. Kraakman, 'Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy', 2 J.L. Econ. & Org. 53 (1986) (CP) (focus on pp 53-66 and 81-100)
- Possfund Custodian Trustees v Diamond [1996] 2 All ER 774, [1996] 1 WLR 1351 (except II. The applications to strike out: the preliminary stage) (CP)
- A. Alcock, 'Liability for misinforming the market', [2011] JBL 243
- J. Coffee, 'Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms', 84 B.U. L. Rev. 301 (2004)
- J.D. Cox, 'Understanding Causation in Private Securities Lawsuits: Building on Amgen', 66 Vanderbilt Law Review 1719 (2013)
- D.C. Langevoort, 'Judgment Day for Fraud-on-the-Market: Reflections on Amgen and the Second Coming of Halliburton', 57 Ariz. L. Rev. 37 (2015)

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## 10. INSIDER TRADING AND MARKET ABUSE

In lecture 10 we will look at the regulation of insider trading and market manipulation. The session will mainly be focussed on the harmonised EU rules in this area (i.e. the Market Abuse Regulation – MAR), but we will also make frequent references to the US system for comparison.

#### Core readings:

- \*\* Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (Market Abuse Regulation) (Articles 7-10, 12-15, 17, 20)
- \*\* SM Bainbridge, An Overview of Insider Trading Law and Policy, UCLA School of Law Law-Econ Research Paper No. 12-15 (2012). Available at SSRN: <http://ssrn.com/abstract=2141457>
- \*\* N Moloney, EU Securities and Financial Markets Regulation (3<sup>rd</sup> ed, 2014), chapter 8 pp 699-730

#### Case law

- \* Case C-45/08 *Spector Photo Group NV, Chris van Raemdonck v Commissie voor het Bank, Financie- en Assurantiewezen (CBFA)* [2010] ECR I-12073

Case C-628/13 *Lafonta v Autorité des marchés financiers (AMF)*, [2015] ECR I-0000

Case C-19/11 *Markus Geltl v Daimler AG* [2012]

**Further readings (not required):**

Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive) [overview only]

SM Bainbridge, *The Law and Economics of Insider Trading: A Comprehensive Primer* (2001). Available at SSRN: <http://ssrn.com/abstract=261277>

R. Veil, *European Capital Markets Law* (2013), § 13 and § 14 (note that these chapters predate the newly adopted Market Abuse Regulation and do not take into account the most recent changes)

UK Enforcement: See FCA, “Market Abuse outcomes”, available at: <http://www.fca.org.uk/firms/markets/market-abuse/outcomes>

**11. The Market for Corporate Control: Mergers & Takeovers**

In this lecture we will discuss corporate M&A activity. We will look at the rules governing the acquisition of listed companies in the UK and in other EU member states. We will also look at the harmonised EU rules regarding domestic and cross-border mergers. The lecture is intended to give you an idea of the regulation of M&A activity, and the risks these transactions can pose for shareholders, creditors, and employees.

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**Core readings:**

\*\*Handout on Mergers & Divisions (available on Moodle)

\*\*Handout on EU Takeover Regulation (available on Moodle)

PL Davies, EP Schuster and E van de Walle De Ghelcke, ‘The Takeover Directive as a Protectionist Tool?’ ECGI Working Paper 141/2010 (also available at SSRN: <http://ssrn.com/abstract=1554616>)

**Further readings (not required):**

EP Schuster, “The Mandatory Bid Rule: Efficient, After All?” (2013) 76 *Modern Law Review* 529

V Edwards, ‘The Directive on Takeover Bids – Not Worth the Paper It’s Written On?’ (2004) 1 *European Company and Financial Law Review* 416

T Papadopoulos, ‘EU regulatory approaches to cross-border mergers: exercising the right of establishment’, (2011) 36 *European Law Review* 71

C Gerner-Beuerle, D Kershaw, and M Solinas, ‘Is the board neutrality rule trivial? Amnesia about corporate law in European takeover regulation’ (2011) 22 *European Business Law Review* 559



B Clarke, 'The Takeover Directive: is a little regulation better than no regulation?' (2009) 15 *European Law Journal* 174

L Enriques, 'European Takeover Law: The Case for a Neutral Approach' (2011) 22 *European Business Law Review* 623

## **12. Concluding session: state of European company law harmonisation; potential for regulatory competition and regulatory arbitrage**

We will use this session to revise what we have learned in the previous seminars and embed the revision in a discussion of regulatory competition and arbitrage. We start by introducing the concepts of regulatory competition and regulatory arbitrage. We will then look at the areas of corporate finance law that are likely to be subject to regulatory arbitrage and competition.

### **Core readings:**

Wolf-Georg Ringe, 'Corporate mobility in the European Union – a flash in the pan? An empirical study on the success of lawmaking and regulatory competition' (2013) 10 *European Company and Financial Law Review* 230–267

R Romano, 'Law as a product: Some Pieces of the Incorporation Puzzle', (1985) 1 *J.L.E.&O.* 225

### **Further readings (not required):**

John Armour, 'Who should make corporate law? EC legislation versus regulatory competition' (2005) 58 *Current Legal Problems* 369–413

Lucien A Bebchuk, 'Federalism and the corporation: the desirable limits on state competition in corporate law' (1992) 105 *Harvard Law Review* 1435–1510

L.A. Bebchuk, A. Cohen & A. Ferrell, 'Does the Evidence Favor State Competition in Corporate Law?', (2002) 90 *Cal. L. Rev.* 1775

W. Cary, 'Federalism and Corporate Law: Reflections Upon Delaware', (1974) 83 *Yale L. J.* 663

Simon Deakin, 'Two types of regulatory competition: competitive federalism versus reflexive harmonisation. A law and economics perspective on Centros' (1999) 2 *Cambridge Yearbook of European Legal Studies* 231–260

Martin Gelter, 'The Structure of Regulatory Competition in European Corporate Law' (2005) 5 *Journal of Corporate Law Studies* 247–284

Roberta Romano, *The Genius of American Corporate Law*, AEI Press 1993

V Fleischer, 'Regulatory Arbitrage' (2010) 89 *Texas Law Review* 227