

# **Legal Aspects of Corporate Finance**

## **Module Introduction and Overview**

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# 1 Introduction to the Module

This module, *Legal Aspects of Corporate Finance*, provides an understanding of the essential elements of the legal principles and institutions governing corporate finance at the national and international level. It complements the finance module, *Corporate Finance*, which together provide a comprehensive and coherent appreciation of the financial and legal aspects of the subject.

It is now well-established fact that efficient capital markets depend on well-functioning legal rules and institutions. Legal rules underpin stable financial markets and constitute an important source of their vitality. Law provides the rules of the game for market participants and a vital part of the environment in which savings and investment are encouraged. Law enables financial commitments to be created and respected. Law regulates the conduct of market participants in the market in which the underlying transactions occur. Vibrant financial markets require not only that these legal rules exist but that they operate in an environment where they are effective.

The legal framework that underpins corporate finance is of the utmost importance for the efficient allocation of scarce funds from investors to corporate borrowers. Among other virtues, an efficient framework of corporate law increases the protection of investors and thereby enhances the success and liquidity of securities markets. *Bernard Black* has summarised the ‘wish list’ of individual and institutional investors vis-à-vis corporate borrowers as follows: sound investment decisions are based – among other things – on laws which must give investors, particularly minority shareholders (1) good information about the value of a company’s business; and (2) confidence that the company’s insiders (its managers and controlling shareholders) won’t cheat investors out of most or all of the value of their investment through “self-dealing” transactions (transactions between a company and its insiders or another firm that the insiders control) or even outright theft’ (Black, 2001: p. 783).

In the words of *Lynn Stout*, the relationship between sound legal rules governing corporate relations and securities markets has been emphasised in even clearer terms:

I have a pension fund. At least, I believe I have a pension fund. I believe this because each quarter, I receive statements in the mail that assert that I own shares in several corporations and that these shares have value. I do not know where or how these statements were generated, nor do I know who created them or through whose hands they have passed. I have never seen the stock certificates my financial statements assure me I own, much less the corporate assets that underlie those stock certificates and give them value. I have never met the corporate officers and directors who are supposed to protect those assets and manage them on my behalf. Nevertheless, despite my lack of hard evidence or personal knowledge, I believe I have a pension fund. What’s more, I rely on my belief in making daily decisions. I go out to dinner, the opera and the ball game, spending money now because I believe my pension fund will

provide for my retirement in the future. This is an act of faith. It is an act of trust. It is an act of investor confidence (Stout, 2002: p. 407).

These two aspirations, namely good information about the company's business and confidence that the company's managers and controlling shareholders won't cheat investors, mean that there needs to be a clear set of rules in place which do the following things:

- limit investors' exposure (specifically through the concept of limited liability)
- ensure that a company is a legal 'entity' in its own right (*ie* separate from the investors who own and/or control it)
- demarcate the rights and responsibilities of the three main groups of people involved – investors, managers and lenders
- ensure (so far as is compatible with human nature) that there is transparency and honesty in dealings between a company and its insiders, on the one hand, and the outside world (in particular its 'ordinary investors' and creditors) on the other hand.

If these various elements are in place, then investors will have the confidence to invest, and companies will be able to raise the capital they need (whether debt or equity) on the most favourable terms possible. A good legal framework for corporate finance can thus be seen as part of a virtuous circle that helps to promote a strong securities market, which in turn provides the cheapest finance for the companies that are seeking it. This module will examine the legal components of the necessary institutional framework for vibrant corporate finance in the light of English law.

In March 1998, the UK Department of Trade and Industry (DTI), the predecessor to the Department for Business, Innovation & Skills, commenced a fundamental review of the core of company law led by an independent Steering Group whose remit was to develop a simple, modern, efficient and cost-effective framework for carrying out business activity in Britain for the 21st century. It presented its final report to the Secretary of State on 26 July 2001. The final result of the work carried out on behalf of the DTI was the passing of the 2006 Companies Act, which received Royal Assent on 8 November 2006, and which came fully into force on 1 October 2009. To take account of this, the original module notes have in part been changed and brought up-to-date.

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## 2 The Module Authors

**James Ryder** studied law at Oxford and qualified as a Solicitor of the Supreme Court of England and Wales in 1975. He was in private practice for the whole of his career and worked in London, Hong Kong and Singapore. His area of practice was financial and corporate law, mostly within an international context.

**Apostolos Gkoutzinis** is an associate in the Capital Markets Group of the London office of Shearman and Sterling, a major international law firm, where he advises investment banks and corporations on all aspects of international securities and capital markets law.

Prior to joining the firm, he was Lecturer in Financial Law at the University of London, where he taught a range of courses on international finance and capital markets law. He has also published extensively in international banking and financial law journals and has spoken in conferences and seminars in Europe and the US. Apostolos is a graduate of Harvard Law School (LLM '05), the University of London (PhD '04, LLM '04) and the Aristotle University of Thessaloniki (BA 1997). His book on *Internet Banking Law* was published by Cambridge University Press in November 2006.

**John Cynon-Davies** was formerly a Senior Lecturer in company law at Bristol where he lectured to both undergraduate and postgraduate students. In 1970 he was called to the Bar and practised in Cardiff. His practice included both company law and property law. He has been responsible for revising the module notes and incorporating some of the changes introduced by the 2006 Companies Act.

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### 3 Study Resources

This study guide is your central learning resource as it structures your learning unit by unit. Each of the eight units should be studied within a week. The module is designed in the expectation that studying the unit text and the associated core readings will require 15 to 20 hours during the week.



#### Key texts

Worthington S (2016) *Sealy & Worthington's Text, Cases, and Materials in Company Law*. 11th Edition. Oxford UK, Oxford University Press.

French D (2020) *Blackstone's Statutes on Company Law 2020–2021*. 24th Edition. Oxford UK, Oxford University Press.

Worthington is a clear and reliable text, much used in university teaching of corporate law, and is based largely on particular cases which illustrate different aspects of companies' legislation. You will be asked to read from this text and to answer some questions on your reading at frequent intervals in the unit text.

*Blackstone's Statutes on Company Law* is a collection of statutes of company law for your easy reference to statutory legislation. It is an invaluable reference tool for seeing how companies' legislation has developed, and you should use it throughout the module to establish the precise relationship between the various Acts, and their clauses and amendments.

## Module readings

We also provide you with access to academic articles and other reports and material that are assigned as core readings in the study guide. You are expected to read them as an essential part of the module. You will also be directed to a number of websites where you will be asked to read articles, white papers, and reforms.

## Virtual Learning Environment

You will occasionally be asked to look at specific cases or statutes not contained within your module materials, and these will be made available via the Virtual Learning Environment. You will be asked to look at cases and readings drawn from the **Westlaw** database and **Lexis® Library**. Both of these are accessible through the University of London Online Library, via the VLE. Click on the 'Online Library' tab and follow the instructions. You will need to have your Athens username and password to log in.

## 4 Module Overview

### Unit 1 Incorporation and the Corporate Constitution

- 1.1 Introduction
- 1.2 Corporate Personality and Limited Liability
- 1.3 Types of Company
- 1.4 How a Company is Formed
- 1.5 A Company's Constitution
- 1.6 Corporate Capacity
- 1.7 Articles of Association
- 1.8 How a Company Acts
- 1.9 Groups of Companies
- 1.10 Conclusion

### Unit 2 Financial Structure and Membership

- 2.1 The Concept of Capital and the Financing of Companies
- 2.2 Share Capital
- 2.3 Capital Maintenance
- 2.4 Prohibition on Financial Assistance
- 2.5 Profit Distributions
- 2.6 Different Classes of Shares
- 2.7 Legal Incidents of Membership (Ownership of Shares)
- 2.8 Transfer of Shares
- 2.9 Debt Capital-Debentures
- 2.10 Conclusion

### Unit 3 The Taxation of Companies

- 3.1 Background issues
- 3.2 UK Corporation Tax
- 3.3 Cross-border Taxation
- 3.4 Conclusion

## **Unit 4 Corporate Governance**

- 4.1 Division of Power between Shareholders and Directors
- 4.2 Directors
- 4.3 Directors' Meetings
- 4.4 Shareholders' Meetings
- 4.5 Directors' Duties
- 4.6 Fair Dealing by Directors
- 4.7 Breach of Duty and Third Parties
- 4.8 Shareholders' Remedies
- 4.9 Conclusion

## **Unit 5 Public Disclosure of Information**

- 5.1 Introduction
- 5.2 Financial Statements
- 5.3 Auditors
- 5.4 Other Information to be Made Available
- 5.5 Registration of Charges (Security Interests)
- 5.6 Company Investigations
- 5.7 Conclusion

## **Unit 6 Raising Capital from the Public**

- 6.1 Introduction
- 6.2 Securities Markets and Securities Regulation Generally
- 6.3 Securities Regulation in the UK
- 6.4 Public Securities Offerings
- 6.5 Liability for Misstatements in Listing Particulars and Prospectus
- 6.6 Insider Dealing
- 6.7 Market Abuse
- 6.8 Corporate Finance Transactions
- 6.9 Conclusion

## **Unit 7 Regulation of Takeovers and Mergers**

- 7.1 Introduction
- 7.2 Overview of Statutory Regime
- 7.3 Methods of Takeover
- 7.4 Takeover Code
- 7.5 Listing Rules
- 7.6 Compulsory Buy-out
- 7.7 Competition Law Aspects
- 7.8 Directors' Role in a Takeover
- 7.9 Conclusion

## **Unit 8 Corporate Collapse**

- 8.1 Insolvency Law – Introduction
- 8.2 Overview
- 8.3 Company Voluntary Arrangements (CVA)
- 8.4 Administration
- 8.5 Receivership

- 8.6 Liquidation (Winding up)
- 8.7 The Liquidation Process
- 8.8 Effect on Prior Transactions
- 8.9 Trading While Insolvent
- 8.10 Conclusion

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## 5 Learning Outcomes

When you have completed your study of this module, you will be able to:

- outline and discuss the importance of corporate law for the creation of strong securities markets
- analyse the concepts of corporate personality and limited liability, the types of companies, the formation of the most important types of companies and key aspects of corporate constitutions
- explain and critically discuss the legal components of the financial structure and membership of corporations
- examine and discuss the key issues relating to the taxation of corporate profits and their implications for international competition in trade and investment
- outline and discuss the division of power between shareholders and directors in the internal governance of corporations and issues of liability relating to the obligations and rights of those – often competing – groups
- critically assess the legal aspects of corporations' attempts to raise finance from the public
- outline and discuss important legal and regulatory developments relating to takeovers and mergers against the background of general corporate law.