

Theory of the Firm, History of Principles of Corporate Law

Principles of Corporate Law/Gesellschaftsrecht –

Lecture 1

September 19, 2022

Professor Kern Alexander

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- L1 **Introduction**, Theory of the Firm, Common Principles of Corporate Law across Jurisdictions (KA) (19 Sept)
- L2 **Role of the Board of Directors, Role of Shareholders, Management & Agency problems (KA) (26 Sep)**
- L3 **Corporate Personality, Formation, Separate Legal Entity Principle, Limited Liability (KA) (3 Oct)**
- L4 **Corporate Finance, Capital Raising and Maintenance – The Prospectus and Audit/Accounting (KA) (10 Oct)**
- L5 **European Company Law: Free Movement and Capital Structure (KA) (17 Oct)**
- L6 **Investor Protection, Shareholder Control Issues, and Minority Shareholders Rights, Ethics & Corruption (DR) (24 Oct)**
- L7 **Insider Dealing, Market Abuse and Fraud (KA) (31 Oct)**
- L8 **Data Law (DR) (7 Nov)**
- L9 **Compensation and Bonuses (DR) (14 Nov)**
- L10 **Corporate Governance, Stakeholders and Corporate Social Responsibility (MdE) (21 Nov)**
- L11 **Takeovers and Mergers (DR) (28 Nov)**
- L12 **Corporate Governance and Technology (MdE) (5 Dec)**
- L13 **Gatekeepers - Auditors and Accountants (MdE) (12 Dec)**
- L14 **Selected Topics and Exam Review (KA) (19 Dec)**

Gesellschaftsrecht

- Introduction
- Administration
- Exam structure
- Misc.

Information & Website (1)



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Aktuelle und frühere Vorlesungen an der UZH

↓ Principles of Common Law HS22 (PDF, 208 KB)

↓ Gesellschaftsrecht (II) / Principles of Corporate Law HS22 (PDF, 134 KB)

→ [International Financial Law FS22](#)

↓ European Economic Law

↓ International and European Financial Law

Research Network for Sustainable Finance



Professor Kern Alexander präsentiert am International Monetary Fund, 29.-30. Juni 2022

Der International Monetary Fund lud Kern Alexander ein, sein Papier "Banking Regulation and Climate Change" (Bankenregulierung und Klimawandel) auf einem hochrangigen Seminar zu präsentieren, das der IMF am 29. und 30. Juni 2022 in seinem Hauptsitz in Washington DC veranstaltete.




Oxford Bank Governance Programme 11. - 15. Juli 2022

Kern Alexander war Co-Direktor des Oxford Bank Governance Programme 2022, das an der Saïd Business School der Universität Oxford stattfand. Zu den Teilnehmern gehörten Direktoren und leitende Angestellte von führenden Banken, Versicherungen und Finanzdienstleistern.

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Lectures

- The lectures will be held on **Monday**
- **14:00 - 15:45**
- starting **19 September 2022**
- Last lecture **19 December 2022**
- Due to the Covid-19 the lecture will be held online on Zoom as livestream.
 - Recordings will be available to view online after the lecture
 - Please monitor Lehrstuhl Website for updates
- **Lecturers:**
Prof. Dr. Kern Alexander, Prof. Marco Dell'Erba & Dr. David Bertrand Roth

Information regarding lecture prerequisites

➤ Prerequisites:

- Gesellschaftsrecht
- Corporate Law
- Company Law
 - Reading: Bauen/Bernet 'refresher'
- Syllabus
- Readings (mandatory & optional)

Assessment

- Written open book exam
- Exam date and location will be announced
- English
- Review previous exams
- Dictionaries permitted
- No correction of grammar, style, or spelling (structure!)
- Grades awarded: 1-6 (0.5)
- Passing grade: 4

Miscellaneous

- Master's Thesis
- Exchange students
- Contact:
Ist.alexander@rwi.uzh.ch

1. Lecture: Theory of the Firm, Common Principles of Corporate Law across Jurisdictions (KA) (19 Sept)

Why do we have companies? General principles of corporate law. What are the common principles of corporate law across jurisdictions? What are some dissimilar principles of corporate law? Discuss the contractarian vs. communitarian perspectives of the firm. What is the "shareholder supremacy" model?

KERN ALEXANDER, *Corporate and Banking Law, in Introduction to Swiss Law, Marc Thommen (ed.), 2022, pp. 341-344*

KERN ALEXANDER, *Corporate and Banking Law, in Introduction to Swiss Law, Marc Thommen (ed.), 2022, pp. 345-348*

M. FRIEDMAN, *A Friedman doctrine – "The Social Responsibility Of Business Is to Increase Its Profits", The New York Times, 13.09.1970*

RONALD COASE, *The Firm, The Market, And The Law, Chapter 2 'The Nature of the Firm' (The University of Chicago Press, Chicago 1988), pp. 33-55*

THE ECONOMIST, *Coase's theory of the firm (July 27th 2017)*

JANET DINE, *Company Law, Chapter 2 'How Did We Get There?: Tools for Company Law Analysis' (Sweet & Maxwell 2001), pp. 13-39.*

FREER AND MOLL, *Principles of Business Organizations, Chapter 4 'The Corporation: Overview, Theory and History', pp. 139-151*

ROBERT HAMILTON, *Chapter 1 'Introduction', pp. 1-15.; Chapter 2 'Risk', pp. 18-25; Chapter 14 'The Role of the Shareholder'*

2. Lecture: Role of Board of Directors, The Role of Shareholders, Management & Agency Problems (KA) (26 Sept)

Management and agency problems. What are the main problems in modern boards? How director's duties address the principal-agent problem? How are corporate boards of directors in Western Europe different from the US? Do directors' have duties to the corporation or to shareholders? Are their duties aimed at resolving the principal-agent problem? Should there be international standards governing the regulation of corporate governance? Or should it be left to individual states or regional trading areas?

KERN ALEXANDER, *Corporate and Banking Law, in Introduction to Swiss Law, Marc Thommen (ed.), 2022, pp. 349-353*

E. MERRICK DODD, *For Whom are Corporate Managers Trustees*, The Harvard Law Review, Vol 45 No 7, (May 1932), pp. 1145 – 1163.

A. A. BERLE, *For Whom Corporate Managers are Trustees: A Note*, The Harvard Law Review, Vol 45 No. 8 (June 1932), pp. 1365 – 1372.

FREER AND MOLL, *Principles of Business organizations*, pp. 189-229, 251-255, 262-267.

LEO E. STRINE JR., *'One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed For The Long Term Unless Their Powerful Electorates Also Act And Think Long Term?'*, (November 2010).

The Times – Duty on shareholders when voting

3. Lecture: Corporate Personality, Formation, Separate Legal Entity Principle, Limited Liability & Corporate Group Liability (KA) (3 Oct)

Memorandum of Association. Articles of Association. Public and private companies.
Separate legal entity. Salomon principle. Piercing the veil. Corporate groups.

KERN ALEXANDER, *Corporate and Banking Law, in Introduction to Swiss Law, Marc Thommen (ed.), 2022, pp. 383-385*

FREER AND MOLL, *Principles of Business organizations, chapter 5*

DINE / KOUTSIAS, *Chapter 1 'Starting a Company' pp.1-17; Chapter 3 'The articles of association', pp. 28-42.*

SIKA Articles of Incorporation (example of a Swiss company limited by shares)

Table A (UK Model Articles of Association of a public company limited by shares)

4. Lecture: Corporate Finance, Capital Raising and Maintenance – The Prospectus and Audit/Accounting (KA) (10 Oct)

Corporate finance theory, Why companies raise capital? What type of capital and capital maintenance. What is a prospectus? What is required in a prospectus and liability for misstatements? Contrast EU, US and Swiss law

What are the roles of gatekeepers, such as accountants / auditors, lawyers, rating agencies and other intermediaries?

C-441/93 Pafitis and Others v TKE and Others

Bonn and Schmitt Avocats – New Ruling Prospectus

HAMILTON – Chapter 9 „Financial Structure“

5. Lecture: European Company Law: Free Movement and Capital Structure (KA) (17 Oct)

Free Movement. EU company law. Treaty provisions and enactment of directives. Right of establishment. Free movement of capital. European structures.

C-409/06 *Winner Wetten GmbH v Bürgermeisterin der Stadt Bergheim*, Judgment of 8 September 2010

BRENDA HANNIGAN, *Company Law* (OUP 2009), 'The European Framework', pp. 32-52

ANDENAS / WOOLDRIDGE, *European Comparative Company Law* (Cambridge University Press, 2009), pp. 7-33

C-359/12 *Michael Timmel vs. Aviso Zeta AG*, Judgement of 15 Mai 2014

Financial Times, one share one vote

6. Lecture: Investor Protection, Shareholder Control issues, and Minority Shareholders Rights, Ethics & Corruption (DR) (24 Oct)

Corporate law and investor protection. Is there a duty of stewardship? Control rights and related-party transactions. Control issues and protecting minority shareholders. How does the legal origin of shareholder rights affect corporate governance?

Financial Times, Rossbach – A cautionary tale of power

The Economist, *Swiss Takeover Law, Avalanche in the Alps* (21 February 2015)

Case C-101/08 *Audiolux SA v Groupe Bruxelles Lambert SA (GBL)*, Judgment of 15 October 2009

R. LA PORTA/F. LOPEZ-DE-SILANES/A. SHLEIFER/R. VISHNY, *Investor Protection and Corporate Governance*, in: Journal of Financial Economics, 58 (2000), pp. 3-27.

LUCIAN BEBCHUK, *The Myth of Hedge Funds as “Myopic Activists”*, Wall Street Journal (6 August 2013)

MARTIN LIPTON, *Bite the Apple; Poison the Apple; Paralyze the Company, Wreck the Economy* (26 February 2013)

TOMOEH MURAKAMI TSE, *Activist Investors Rally to Reclaim Power*, Washington Post (20 March 2013)

STEPHEN FOLEY ET AL., *Activist investors learn to mind their manners*, Financial Times (7 August 2015)

DAVIES / HOPT / RINGE, Chapter 8: Control Transactions, in: Kraakman et al. (eds.), *The Anatomy of Corporate Law*, 3rd. ed., 2017, pp. 205-242.

Financial Times, *Saint-Gobain gives up fight for control of SIKA* (14 September 2018)

7. Lecture: Insider Dealing, Market Abuse and Fraud (KA) (31 Oct)

The nature of market abuse and manipulation, the rationale for control of market abuse, criminal and civil offences, corporate fraud

KERN ALEXANDER, *The Law of Insider Dealing – A Tale of Two Jurisdictions*

HENRY G. MANNE: *Entrepreneurship, compensation, and the corporation*, in: Bainbridge, Stephen M. (ed.), *Research Handbook on Insider Trading*, Cheltenham/Northampton 2013, 67-79

KATJA LANGENBUCHER: *Insider Trading in European Law*, in: Bainbridge, Stephen M. (ed.), *Research Handbook on Insider Trading*, Cheltenham/Northampton 2013, 429-448

Financial Times, Binham and Thompson – Barclays at risk of fresh fraud charges over Qatar cash call

Financial Times, Binham – What is the Barclays fraud case about

International New York Times, Stewart – Muddled insider trading laws need clarity

**Week 8: Reading week and conference (9th November, 2pm
– 6 pm, optional)**

8. Lecture: Compensation and Bonuses (DR) (14 Nov)

Compensation and Bonuses

MICHAEL C. JENSEN, *Foundations of Organizational Strategy, Part III 'Compensation'*, (1998 Harvard University Press), pp. 197-228

EINER ELHAUGE, Horizontal Shareholding (129 Harv. L. Rev. 1267–1317 [2016])

9. Lecture: Corporate Governance, stakeholders, and corporate social responsibility (MdE) (21 Nov)

Corporate Governance, employees as stakeholders and Corporate Social Responsibility

JOHN PARKINSON, *Models of the company and the Employment Relationship*, in: *British Journal of Industrial Relations* (September 2003), pp. 481-509

JANET DINE, '*Corporate Regulation, Climate Change and Corporate Law: Challenges and Balance in an International and Global World*' (2015) 26 *European Business Law Review*, Issue 1, pp. 173–202

EDWARD B., *For Whom is the Corporation Managed in 2020?: The Debate over Corporate Purpose* (May 1, 2020), ECGI - Law Working Paper No. 515/2020. Available at SSRN: <https://ssrn.com/abstract=3589951>

10. Lecture: Takeovers and Mergers (DR) (28 Nov)

What is meant by the market for corporate control? How important should the market for corporate control be in influencing corporate governance? How are takeovers a governance mechanism? Discuss the main takeover defenses in the reading and whether they are good for shareholders?

JONATHAN MUKWIRI, *Takeovers and the European Legal Framework: A British Perspective*, Routledge-Cavendish, 2009

PAPADOPOULOS, THOMAS GR, *EU Law and the Harmonization of Takeovers in the Internal Market*, Wolters Kluwer, 2010

JOHN REVILL, *Sika Exposed to Takeover After Shareholder Vote on Charter*, The Wall Street Journal (15 April 2015)

11. Lecture: Corporate Governance and Technology (MdE) (5 Dec)

The role of technology in Corporate Governance. How Artificial Intelligence (AI), Blockchain, and Internet of Things (IoT) are reshaping corporate governance.

LUCA ENRIQUES AND DIRK ZETZSCHE, *Corporate Technologies and the Tech Nirvana Fallacy* (March 25, 2020). Hastings Law Journal

CHRISTOPHE VAN DER ELST AND ANNE LAFARRE, *Blockchain and Smart Contracting for the Shareholder Community* (July 24, 2018). ECGI – Law Working Paper No. 412/2018

MARK FENWICK, WULF KAAL, AND ERIK P.M. VERMEULEN, *The ‘Unmediated’ and ‘Tech Driven’ Corporate Governance of Today’s Winning Companies*. *New York University Journal of Law & Business* (2020)

FLORIAN MÖSLEIN, *Robots in the Boardroom: Artificial Intelligence and Corporate Law* (September 15, 2017). in: Woodrow Barfield and Ugo Pagallo (eds), *Research Handbook on the Law of Artificial Intelligence*

STILPON NESTOR, *Corporate Governance 2030: Thoughts on the Future of Corporate Governance* (December 26, 2018), Harvard Law School Forum on Corporate Governance. Available at <https://corpgov.law.harvard.edu/2018/12/26/corporate-governance-2030-thoughts-on-the-future-of-corporate-governance/>

12. Lecture: Role of Gatekeepers – Accountants, Auditors, and Rating Agencies – a “True and Fair View” (KA) (12 Dec)

The Financial Reporting Council, True and Fair

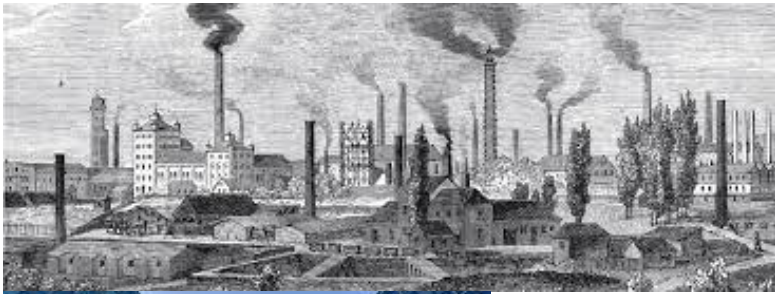
Caparo Industries Plc v Dickman (1990) 2 AC 605

13. Lecture: Exam review - selected topics (MdE/KA) (19 Dec)

Summing up of topics. Exam structure and duration. Exam location. Measures due to the current circumstances. Mock exam and discussion of exam strategies.

Main points

- Main attributes of the corporation
- Coase and the theory of the firm
- Theories of company law
- Public or private purpose of company
- Corporate constitution



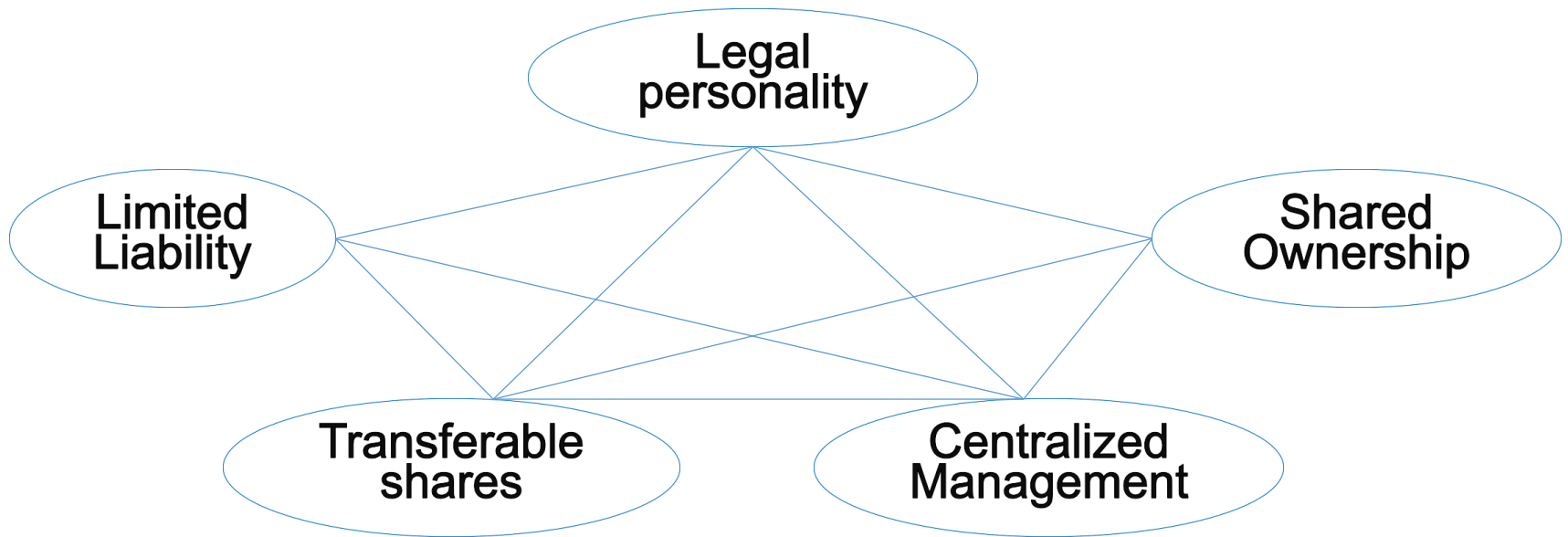
Main points

- *Coase*: contracts and transaction costs
- *Pigou*: regulation and externalities
- What is a corporation: private property of shareholders used to advance a common interest
- History
 - Royal charters: ecclesiastical, municipal & charitable
 - Merchant guilds (14th c). Colonial (16th c): E. India (1600), South Sea (1702), Commercial: Bank of England (1694)
- Corporate theories – contract, concession & communitaire models
- Attributes of the modern corporation
 - Separate entity with perpetual existence
 - Limited liability for corp obligations limited to corp property
 - Centralised management
 - Transferability of ownership interests

Corporate formation and ongoing formalities

- Comply with statutory requirements. Incorporators file document with state – articles of incorporation and/or memorandum of association. Registered agent and agent for service of documents
- Ongoing formalities – annual reports, shareholder/directors meetings, taxes. Contrast with partnerships and sole proprietorships
- Separate entity, legally distinct from owners and managers
- Limited liability – ‘greatest advantage of the corporate form’
- Corporate shareholders are its owners – issuance of stock
- Board of directors are the managers – contrast partnership
- Transferability of shares, taxes on profits/dividends,
- Corporate funding – equity/shareholders, debt/creditors

What is a Corporation



Law and economics theory

- Transaction cost economics – ‘[a]lthough production could be carried out in a completely decentralized way by means of contracts between individuals, the fact that it costs something to enter into these transactions means that firms will emerge to organize what would otherwise be market transactions whenever their costs were less than the costs of carrying out the transactions through the market. The limit to the size of the firm is set where its costs of organizing a transaction become equal to the cost of carrying out it out through the market.’ Coase – ‘The Nature of the Firm’
- Private contracting to bargain around externalities
- Government regulation/intervention distorts allocation of resources and creates further (unforeseen) costs
- Coasean theory – *regulation should reduce obstacles to contracting around externalities*



Ronald Coase

*29 December 1910 – 2 September 2013,
(Chicago School)*

Legal Personality

- Nexus of contracts? Better a nexus «for» contracts?
- The core element: Separate corporate assets
- 3 sets of rules:
 - 1) Separation of corporate assets: **Entity shielding**
 - a. **Priority Rule:**
 - i. **Creditors of the firm, as security for the firm's debts, have a claim on the firm's assets that is prior to the claims of the personal creditors of the firm's owners.** (This rule is shared by modern legal forms for enterprise organization, including partnerships).
Consequence:
 - ii. –a firm's assets are, as a default rule of law, automatically made available for the enforcement of contractual liabilities entered into in the name of the firm.
–By thus bonding the firm's contractual commitments, the rule makes these commitments credible.
 - b. **Liquidation Protection (only for corporations and not for partnerships)**
 - i. The individual owners of the corporation (the shareholders) cannot withdraw their share of firm assets at will, nor can the personal creditors of an individual owner foreclose on the owner's share of firm assets.
 - ii. Such withdrawal or foreclosure would force partial or complete liquidation of the firm.
 - iii. Function: **to protect the going concern value of the firm against destruction by individual shareholders or their creditors.**
 - Legal entities characterized by both these rules have **“strong-form” entity shielding**, as opposed to the **“weak-form” entity shielding** found in partnerships (only priority rule)
 - By separating the value of the firm from the personal financial affairs of the firm's owners, strong-form entity shielding facilitates tradability of the firm's shares

Legal Personality

- 1) Separate Patrimony
- 2) Rules specifying to third parties the individuals who have authority to buy and sell assets in the name of the firm, and to enter into contracts are bonded by those assets
- 3) Rules specifying the procedures by which both the firm and its counterparties can bring lawsuits on the contracts entered into in the name of the firm.



REDUCE THE COSTS OF DOING BUSINESS

Limited Liability

- Limited liability shields firm's owners from creditors claims
 - Economic consequences: *favoring diversification*
- «Owner shielding» vs «Entity shielding»
 - **Complementarity** of the two:
 - Entity shielding protects the assets of the firm from the creditors of the firm's owners
 - Limited liability protects the assets of the firm's owners from the claims of the firm's creditors.



Ensure that business assets are pledged as security to business creditors, while the personal assets of the business's owners are reserved for the owners' personal creditors.

“As creditors of the firm commonly have a comparative advantage in evaluating and monitoring the value of the firm’s assets, and an owner’s personal creditors are likely to have a comparative advantage in evaluating and monitoring the individual’s personal assets, such asset shielding can reduce the overall cost of capital to the firm and its owners. **It also permits firms to isolate different lines of business—**and focus creditors’ monitoring efforts **accordingly—by incorporating separate subsidiaries”**.

Transferable Shares

- Transferability: Conduct business **uninterruptedly**
- Fully Transferable vs Freely tradable shares
- Fully transferable shares do not necessarily mean *freely tradable* shares.
 - Even shares transferable may not be tradable without restriction in public markets, but just transferable among limited groups of individuals or with the approval of the current shareholders or of the corporation.
 - Free tradability maximizes:
 - the liquidity of shareholdings and the ability of shareholders to diversify their investments.
 - flexibility in raising capital.
- Corporations with freely tradable shares are “open” or “public” corporations,
- Corporations with restrictions on the tradability “closed” or “private” corporations.
- Two further distinctions:
 - Shares of open corporations may be listed for trading on a stock exchange, in which case we will refer to the firm as a “listed” or “publicly traded” corporation, in contrast to an “unlisted” corporation.
 - A company’s shares may be held by a small number of individuals whose interpersonal relationships are important to the management of the firm: “closely held” as opposed to “widely held.”

“Transferability of shares connected both with the liquidation protection that is a feature of strong-form legal personality, and with limited liability.

Absent either of these features, the creditworthiness of the firm as a whole could change, perhaps fundamentally, as the identity of its shareholders changed.

The value of shares would be difficult for potential purchasers to judge. Ensuring a single price for shares, independent of the wealth of the purchaser, permits securities markets to aggregate information about the firm’s expected future performance through its stock price.

Moreover, a seller of shares could impose negative or positive externalities on his fellow shareholders depending on the wealth of the person to whom he chose to sell.

It is therefore not surprising that strong-form legal personality, limited liability, and transferable shares tend to go together, and are all features of the standard corporate form everywhere.

This is in contrast to the conventional general partnership, which lacks all of these features”

Theory of welfare economics

- Private contracting can create negative externalities for society (social costs)
- The role of regulation: to reduce sources of market failure and incentivise parties to incur the full costs of their private transactions (reduce social costs).
- Bounties, duties and taxes can be imposed on the company causing the externality (Pigouvian taxes). AC Pigou, *Welfare Economics*



Arthur Cecil Pigou

18 November 1877 – 7 March 1959

*(Fellow of King's College, Cambridge and
Professor of Economics, Univ of Cambridge)*

Theories of Company Law

Contractual theories

- Companies arise from a nexus of contracts (private law), minimal state regulation

Concession theories

- State created and public regulation

Communitaire theory

- companies are a mere instrument of the state



“American corporations exist only because the American people grant them charters. Those charters confer valuable privileges
– such as limited legal liability for their owners – that enable businesses to turn a profit. What do Americans get in return? What are the obligations of corporate citizenship in the U.S.?”

Theories and Doctrines of the Company

- Public or private purpose?
- **Concession theory:** role of state in creating companies – enticing incorporators to invest
- **Contractualist view:** incorporators as ‘economic heroes’ – *laissez faire* view
 - **Limited liability:** enabling & incentive to invest
 - **Legal contractualism:** ‘aggregate theory’ private law contracting between members and between members and management
 - **Economic contractualism:** neo-classical liberalism view to reduce transaction costs – ‘voluntary association between shareholders’, not as much ‘a creation of the state’. ‘[N]et gain must be greater than the net loss’.

Economic theories of the company

- Economic contractualism – *Kaldor-Hicks efficiency* – *greatest economic benefit to society justifies transaction even if some parties lose*
 - Efficiency, rationality/self-interest, and information. The problem of externalities
- ‘Nexus of contracts’
 - reduce transaction costs
- Limited liability: enabling acts, facilitate efficient management of business
- Principal-agent problem and asymmetric information

Political Theories of Company Law (1)

- *Hayek* – procedural equality & fair dealing, despite the result
- *Kant & Hegel* – political equality & equality of autonomy of individual
- *J.S. Mill* – ‘Where there is an ascendant class, a large proportion of the morality of the country emanates from its class interests’
- *Marx* – individual’s place in world determines actual equality; rejected *Hegel & Kant* for ignoring basic inequalities of birth, occupation & property.
- *Rawls* – just difference principle, ‘justice as fairness’, principles to govern just society derived from ‘behind a veil of ignorance’.

Political Theories of Company Law (2)

Rawl's original position – 2 principles

- Equality in the assignment of basic rights & duties
- Social & economic inequalities are just only if they result in benefits for everyone, especially for the 'least advantaged members' of society

Corporate law theories (Common Law)

- Aggregate theory, UK Companies Act 2006 s. 33(1) ‘the provisions of a company's constitution bind the company and its members to the same extent as if there were covenants on the part of the company and of each member to observe those provisions...’ but limits on member enforcing the articles – rule of *Foss v Harbottle* (1843)
- Contractual relationships determinative of obligations/duties of Board
- Majority decision of contractors represents company will. Contractually negotiated rules of company governance by shareholders serves as will of the corporation.
- Corporation entitled to autonomy from state – classical laissez-faire approach – emerges as common western state practice in 19th century

Lecture 1 - Summary

- Historical attributes of the company
- Corporate doctrines and theories – i.e., separate legal personality, limited liability and economic & legal contractualism