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Overview

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Basic Concepts of Corporate Law

Dr David Roth
Principles of Corporate Law
Fall Semester 2025
Lecture 1

Information regarding Podcast

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Information & Website

- Chair Alexander: ius.uzh.ch/alexander
- UZH login required
- Please monitor Lehrstuhl website for updates

Where & When

- The lectures will be held on **Monday**
- **14:00 - 15:45**
- **Starting today, 15 September 2025**
- **Lecturers:**
  - Course leader: Prof Kern Alexander
  - Co-lecturer: Dr David Roth
  - Guest lecturers

Information regarding lecture prerequisites

- Prerequisites:
  - Gesellschaftsrecht
  - Corporate Law
  - Company Law
- Syllabus (continually updated)
- Readings (no more optional readings)

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Assessment

- Booking of exam via 'Modulbuchungstool' → «student services UZH»
- **Check the deadline!**
- **Can be cancelled until the deadline!**
- **Otherwise counts as a fail (1.0) 'Fehlversuch'**
- If you have questions regarding the module booking
  (or questions not specifically related to the course)
  please contact the 'Studienberatung' → «student advisory service»

Assessment

- Written examination
- English
- Essay questions
- Dictionaries permitted
- No correction of grammar, style, or spelling (structure!)
- Grades awarded: 1-6 (0.5)
- Passing grade: 4

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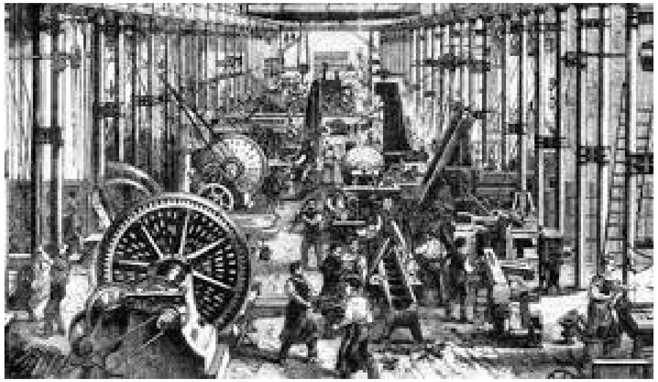
Overview

- «The theory» of the firm, complementary views and welfare economics
- Theories / models of company law
- Key attributes of the corporate form



«The theory» of the firm

- Industrial organisation (IO) – microeconomics
- No definite theory
- What is a «firm» and which are/is its (efficient) boundaries/size?
- Classic (technical) view: profit maximisation
  - Black box with input (material, work) and output (products)
  - Relevant factors: revenue (R), cost (c), quantity (q); profit (pi)

$$max\, \pi(R,\, C) = R(q) - C(q)$$

- Complementary views → filling the black box:
  - Transaction cost theory
  - Agency theory
  - Property rights theory

Transaction cost theory

- Make or buy-decisions in light of transaction costs
  - Make: internally
  - Buy: externally
- (External) transaction costs:
  - Incur in addition to the input-price
    → «the costs of using the price system», the market
  - Examples
- Profit maximising behaviour is to buy externally
  when (external) transaction costs («marketing costs»)
  are lower than organising internal production
  - Condition: equal costs of production
  - Costs of organising internal production: «internal» transaction costs

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Transaction cost theory

- Short-term vs long-term, continuing obligations
  - Examples
  - Contracting for every possible future situation? (-)
    → Incomplete contracts
  - Effect of incomplete contracts on transaction costs
    (namely surveillance, enforcement, renegotiation)
    + opportunistic behaviour by counterparty
- Avoiding the additional costs of incomplete contracts through internalisation
- Legally enforced rules (contract, property, penalty law) may reduce transaction costs and thereby promote external acquisition of input;
  but: government regulation may also create further (unforeseen) costs

Ronald Coase

- Dec 29, 1910 (London) – Sept 2, 2013 (Chicago)
- *The nature of the firm*, 4 (1937) Economica 386
  «[T]he operation of a market costs something and by forming an organization and allowing some authority (an 'entrepreneur') to direct the resources, certain marketing costs are saved.»
- *The problem of social cost*, 3 (1960) J.Law & Econ. 1
- Nobel Price winner 1991 «for his discovery and clarification of the significance of transaction costs and property rights for the institutional structure and functioning of the economy.»
- Other key scholars: Oliver Williamson, Oliver Hart, Bengt Holmstrom

Agency theory

- Also: principal-agent problem
- Information asymmetries and non-corresponding (self-)interests
  → conflicts of interests
- Agency costs
  - Examples
  - Negative effect on profit maximisation
- How to align principal and agent interests?
- Key scholars: Michael Jensen, William Meckling, George Akerlof, Eugene Fama

«The directors of such companies … being the managers rather of other people's money than of their own, it cannot be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own.» (Adam Smith, 1778)

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Property rights theory

- Role of property rights for economic performance
- A firm is the sum of all it residual rights
- Residual right: An asset that is not affected by an incomplete contract
- Key scholars: Harold Demsetz, Armen Alchian

Welfare Economics

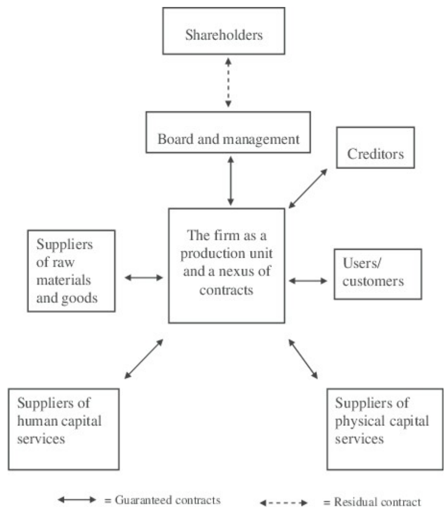
- Separate branch of economics
- Insight: Private contracting can create social costs, i.e. negative externalities for society
- Situations in which individual incentive for rational behaviour do no lead to rational outcomes for the group → «market failure»
  - Abstract definition: Inefficient distribution of goods
  - Examples
- Role of regulation: Reduce sources of market failure and incentivize parties to incur the full costs of their private transactions (reduce social costs)
- Key scholars: Arthur Cécile Pigou, Vilfredo Pareto, Amartya Sen

Theories of company law

- Contract theory
- Concession theory (incl. communautaire theory)
- Real entity theory

Contract theory

- Term probably coined in American scholarship
  cf. Henry Butler, *The Contract Theory of the Corporation*, 11 (1989) Geo. Mason L. Rev. 99
- 19th century: «fiction theory»
  – Corporation as a «single nexus» under which rights and obligations are held together through contracts *between shareholders*
  – Corporate law as a branch of partnership law
  – From freedom of contract to freedom of incorporation
- Modern «nexus of contracts» theory
  – Includes all participants, i.e *also stakeholders*
  – Key scholars: Michael Jensen, William Meckling



Concession theory

- History (by the example of UK)
  - Royal charters, Private acts of Parliament
  - Merchant guilds (14th century)
  - Colonial (16th century): Hudson Bay, East India, the South Sea
  - Commercial: Bank of England (1694)
  - South Sea Bubble Act 1720-1844: Almost impossible to obtain charters
    → Strong restrictions on incorporation
- 1844: UK Companies Act allows for registration instead of concession (l.l.: 1855)
- Concession theory today: Role of state in creating and regulating companies
  - «Creatures of the state» - personality (and l.l.) derived from incorporation
  - Companies act on the basis of a «social license»
- Communautaire theory: Companies are mere instruments 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.?"

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Real entity theory

- Company as a «living organism»,
  «a real person, with body and members and will of its own»
- Historically: against (too) high level of shareholder influence
- Focus on autonomous decision making, corporation as a «social structure»
- Key proponents: Otto von Gierke, Walther von Rathenau, Frederic Maitland
- See further: Eva Micheler, *Company Law, A Real Entity Theory*, Oxford 2021

Political Theories of Company Law

- Hayek – procedural equality & fair dealing, regardless of 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 – 'justice as fairness', principles to govern just society derived from 'behind a veil of ignorance'.

Shareholders supremacy model

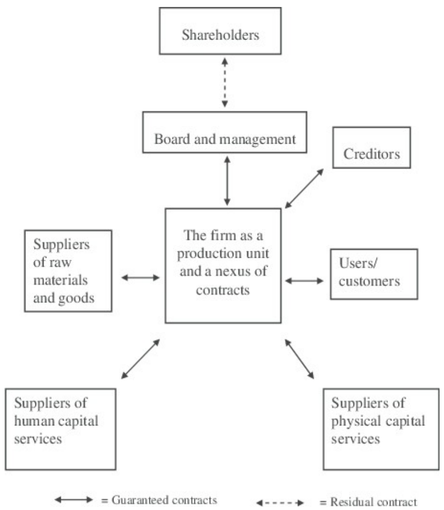
- First priority («primacy») to shareholders:
  «There should be no confusion… A business corporation is organized and carried on primarily for the profit of the stockholders.» (Dodge v. Ford Motor Co., 1919)
- Shareholders as «true owners» of the corporation (Berle & Means, 1932)
- Terminology as a historical explanation? «member»/«owner» (guilds, partnersh.)
- Milton Friedman (1912-2006):
  The link from shareholder primacy to profit maximisation
  - «Corporations have no higher purpose than maximizing profits for their shareholders»
  - «[A] corporate executive is an employee of the owners of the business […] [T]he manager is the agent of the individuals who own the company […] and his primary responsibility is to them.»

Four versions of shareholder primacy

1. Board and managers are accountable to shareholders only
2. Shareholders have excluse right to elect directors and vote on company matters
3. Traditionally: Sole corporate objective is maximizing returns for shareholders
4. More recently: Companies are run according to shareholders' preferences, not just regarding financial returns but also social, political, environmental matters

Residual claimants model

- Shareholders have a superior position in corporation, but why?
- «Owners» of the corporation (-)
- Shareholders as residual claimants
  - Receive payment only after creditors (and other stakeholders) are paid → distribution rules, winding up rules
  - Last-in-line position may incentivise shareholders to act in the best interest of all stakeholders (! negative externalities)



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From shareholderism to stakeholderism

- Stakeholderism as an inclusive form of capitalism
- Stakeholders - Definitions
  - Wide: «Any group or individual who can affect, or is affected by, the achievement of a corporations purpose» (Prof R. Edward Freeman)
  - Narrower: Core constituencies of a company, such as customers, employees, suppliers, shareholders and debt creditors, and communities or the general public
- Addressees of the balancing dilemma: Directors, executives of the company
- Different practical implications depending on the version of stakeholderism (see next slide)

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Four versions of stakeholder capitalism

1. Instrumental – Managers should respect *stakeholders*' interests and in doing so will maximise long-term returns to *shareholders* (cf. Residual claimants model; 4th version of shareholder primacy)
2. Classic – Companies have ethical and legal obligations to stakeholders that must be respected whether or not doing so is likely to maximize shareholder value
3. Beneficial – The corporate objective is improving all stakeholders' well-being (rather than just maximizing value for shareholders)
4. Structural – To protect stakeholder interests, stakeholders other than shareholders should have formal powers in corporate governance

See further: Lynn S. Paine, *What does…*, Harv. Business Rev. Magazine 09/10, 2023

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Key attributes of a corporation