Master Course "Corporate Law and Economics"
Summer School of Law, Business and Economic Policy
Faculty of Business and Economics
University of Basel

Professor Ryan Bubb
School of Law
New York University

Summer 2023

Course description

This course will examine how corporate law helps to mitigate the economic challenges posed by the organization of business enterprise. After discussing the fundamental legal and economic aspects, we will discuss issues such as (1) incentive problems, (2) executive compensation, (3) shareholder voting, (4) investor activism, (5) the market for corporate control as well as (6) corporate social responsibility.

We will begin with some fundamentals: What are the core <u>legal</u> characteristics of the corporate form of a legal entity and what purposes do they serve? One of those legal characteristics is to provide stronger forms of "asset partitioning," by designating a pool of business assets that are distinct from the personal assets of the firm's owners and managers and giving the claims of the firm's creditors priority over those assets ("entity shielding") and in turn shielding the assets of the firm's owners from the obligations of the firm ("limited liability"). Entity shielding in particular is sometimes referred to as an aspect of the "legal personality" of a corporation. After considering the economic functions of the asset partitioning provided by the corporate form, we will turn to a closely related legal characteristic that distinguishes the corporation from some other forms of legal organization: fully transferable ownership interests.

The final two core legal characteristics of the corporate form that dominates modern economic life are closely related: the centralization of managerial authority in an elected board of directors that in turn hires professional managers to run the firm and the allocation of ownership rights (meaning residual financial claims and control rights) to investors of equity capital in the firm. In addition to exploring the functions served by these features, we will discuss alternatives to investor ownership (e.g., nonprofit status and consumer and supplier cooperatives) and why they play relatively large roles only in certain sectors of the economy.

We will then turn to the <u>incentive problems</u> that result from the centralization of control over the corporate form and examine a range of legal institutions that attempt to address them. First, we will consider in more detail the legal authority and duties of boards of directors, which are charged with supervising the managers of the firm. To frame our analysis of the economic function of fiduciary duties, we will read several judicial opinions from the United States that illustrate the role of fiduciary duties in corporate governance, beginning with perhaps the most famous case in all of American business organizational law, *Meinhard v. Salmon*. That case illustrates an underlying economic principle, which is the inevitable "incompleteness" of enterprise contracts (that is, the contractual arrangements that establish how the various participants in a business enterprise will cooperate). That insight in turn leads to an understanding of fiduciary duties as a legal device for filling in the gaps in enterprise contracts.

Second, we will consider the role of <u>executive compensation</u> in aligning the incentives of managers with the interests of investors. But in addition to considering the optimal design of executive compensation as a matter of economic theory, we will also consider the forces that lead real-world executive pay to often be poorly designed from an incentive perspective and how legal rules attempt to address these institutional problems in pay setting.

Third, we will consider <u>shareholder voting</u> and <u>investor activism</u>. While in principle the right of shareholders to elect the board of directors and to vote on certain fundamental transactions should help protect shareholders' interests and compensate to some extent for their lack of hard contractual rights as residual claimants rather than fixed claimants, in practice shareholder voting suffers from collective action problems. But in recent decades the growth of institutional investors and the resulting so-called "reconcentration of ownership" has led to various forms of institutional investor activism that to some extent surmount those collective action problems. We will examine the recent empirical literature on such shareholder activism as well as consider a detailed case study of a particular activist intervention.

Finally, we will consider the <u>market for corporate control</u>. This is often viewed by corporate law theorists as the ultimate "structural" backstop that protects investor interests—if agency costs grow sufficiently large, the value of the firm's shares will fall to the degree that another firm will be able to profitably acquire the firm and replace its management. But for the market for corporate control to function well requires corporate law to facilitate it. We will examine these issues from both a theoretical perspective as well as by reading several classic takeover cases from the U.S., including *Unocal Corp. v. Mesa Petroleum Co.* and *Paramount v. QVC*.

We will conclude by examining the debate over <u>corporate social responsibility</u>. The traditional legal norm, and more importantly the basic structure of corporate control rights, privileges shareholder interests over the interests of other constituencies of a business corporation. But recent innovations in conceptualizing corporate purpose aim to address social concerns about corporate behavior, including with respect to the environment and to the firm's treatment of workers. We will analyze these competing conceptions of corporate purpose and the advantages and disadvantages of each, including with respect to the interests of workers, other suppliers, customers, and the broader community.

While the course will focus on U.S. corporate law, given the instructor's background, the legal and economic issues we will analyze emerge in every jurisdiction, and we will on occasion take a comparative perspective by discussing variations in corporate law across jurisdictions.

Recommended prerequisites

Introductory courses in both business (e.g., Principles of Business) and economics (e.g., Principles of Economics) are recommended. The Master course "Theory of the Firm" (No. 62651) is highly complementary to this course but distinct—this course will focus on the role of organizational law in constituting and facilitating economic organizations. No prior coursework in corporate law is necessary.

Assessment

You are expected to prepare for and attend every class and participate actively. Grading will be based on class participation (30%) and a final written, closed-book exam (70%).