

# **Legal Aspects of Corporate Finance**



# Legal Aspects of Corporate Finance

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SIXTH EDITION

**Richard T. McDermott**

ADJUNCT PROFESSOR OF LAW  
FORDHAM UNIVERSITY SCHOOL OF LAW



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# Preface

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The first edition of this book was published in 1987. The basic principles of course remain intact, but the ensuing thirty-five years have seen a number of significant developments, including refinements of the poison pill, the indorsement thereof by the Delaware Supreme Court and the New York Legislature, a plethora of litigation — spawning leveraged buyout transactions, the bursting of the dotcom bubble, the Enron and World Com fiascos, the stock option backdating scandal, the repeal of Glass-Steagall, the 2008 Credit Crises and its legislative and judicial aftermath, as well as the transformation of the investment banking business, the emergence of activist shareholders and debt market default activists, and the establishment by the Delaware and New York Courts of a roadmap (*M&F Worldwide, Kenneth Cole*) that controlling shareholders can follow in structuring transactions.

Many of those developments have been addressed in my four revised Editions (1995, 2000, 2006, and 2013) and the Supplements thereto. This Sixth Edition retains the basic organization of the prior editions, presents a number of new cases caused by the 2008 Credit Crises and the emergence of those shareholder and debt market activists, and further supplements the material.

With respect to the book generally, my primary purpose in writing the prior editions, which continues with this Edition, has been to introduce students to the legal nuts and bolts of corporate finance transactions by examining them through the lens of a judge's eye view of the transaction documents and a close reading of precedents, statutes, and administrative regulations. Particular emphasis is placed upon the nature of the legal relationships created by corporate finance documentation and the consequences thereof. As discussed below, a secondary aim of this Edition is to be useful to practitioners and judges.

Of necessity, the transactions dealt with in this book and my course at the Fordham University School of Law touch upon a number of areas of substantive law in addition to state corporation laws, including contracts, torts, real property, anti-trust, negotiable instruments, tax, securities, bankruptcy and creditors' rights, environmental law, constitutional law, and conflict of laws. It is imperative that students understand that effective corporate practitioners are versatile lawyers who apply their substantive knowledge to transactions. They are not technocrats engaged in some arcane subspecialty with little connection to the general scope of the law. In a sense, these lawyers do their "litigating" by discerning and resolving issues at the negotiating table while transactions are being structured and the rights and obligations of the parties are established. The study of statutory and decisional law is

critical in the context of corporate finance because it is essential that deal lawyers understand how legislatures and administrative agencies have addressed corporate and securities law issues and how judges resolve disputes and construe the type of documents those lawyers are drafting.

I continue to include excerpts from various corporate finance documents, such as debentures, trust indentures, preferred stock provisions, convertible security provisions, and acquisition agreements. It has been my experience that it is helpful for students to study the actual form of the documentation under consideration. I have placed the documentation examples in the text rather than as appendices in the back. As a general proposition, I subscribe to the view, originally espoused by Christopher Columbus Langdell of the Harvard Law School (*see Ames, Professor Langdell—His Services to Legal Education*, 20 HARV. L. REV. 12 [1906]), that the most useful way of studying law is an analysis of legal opinions deciding actual cases or controversies. I also believe that the principles of the case method can be utilized to consider and analyze the corporate finance documents themselves. Their terms, often the product of complex and sophisticated negotiations and resulting in workable solutions to a myriad of business and financial issues, while at the same time being responsive to decisional and statutory law, are in a very real sense “the law of the case” with regard to a particular corporate finance transaction. The principal cases are intended to demonstrate why particular provisions are included in the documents, as well as the legal effects of omitting such provisions.

In addition to being familiar with relevant judicial opinions, however, efficient corporate lawyers generally use documents from other transactions as precedents. In the context of corporate finance and related transactions, the views of Professor Langdell were supplemented by Paul D. Cravath, who, more than 100 years ago, advised young lawyers that:

The provisions of the modern reorganization agreement and the modern corporate mortgage are the result of the experience and prophetic vision of a great many able lawyers. Every new provision is suggested either by some decision of the courts or by an actual experience or by some lawyer’s conception of a possible exigency. Ordinarily in drafting a document a lawyer must draw chiefly upon his own experience and the results of his own observation, but corporate mortgages and reorganization agreements are public documents so that each lawyer can have the benefit of the experience of many others. . . . I advise you to adhere to precedent and, in most cases, you will find the long reorganization agreement based on precedent much safer than the agreement half as long drawn by your neighbor who scorns precedent.<sup>1</sup>

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1., Paul D. Cravath, *Reorganization of Corporations in Some Legal Phases of Corporate Financing, Reorganization and Regulation* 153, 178 (1917). *Financing, Reorganization and Regulation* 153, 178 (1917).



The Notes following the cases have been substantially expanded and contain explanatory text and supplemental material that places the judicial decisions and document examples in perspective. In the words of two of the preeminent law professors of the last century, the Notes “present in text form a summary yet comprehensive treatment of the matters with which the [cases] are concerned.”<sup>2</sup> This Edition also contains Prefatory Notes in several Sections to provide context for the principal cases and other materials that follow. The number and breadth of the Notes constitute the principal changes from the five prior editions. They are intended to provide the benefits of a textbook to practitioners and judges, as well as to students. It is hoped that the book will be useful in the law office as well as the classroom. To that end, in addition to substantive comments and other observations, the Notes contain descriptions of cases dealing with issues related to those addressed in the principal ones and the matters under discussion. I have avoided the inclusion of unexplained string cites in the Notes and where appropriate have added page cites for the convenience of the reader and to facilitate legal research.

Professor Christian C. Day of the Syracuse University College of Law has kindly observed that the cases I selected for my previous editions “‘tell a story’ and set up the next cases and sections very nicely.” I am not unmindful, however, that Professor Louis Loss has aptly said “the case method of instruction rapidly approaches the point of diminishing returns as applied to advanced law students,”<sup>3</sup> I have found nevertheless that lectures and the resulting class discussion involving the principal cases and pertinent statutes, in conjunction with relevant excerpts from corporate finance documents, provide an effective presentation of the course material. Based on their evaluations of the Course over the years, my students appear to agree. In an effort to avoid the diminishing returns to which Professor Loss referred, I have expanded the editing of the decisions and also have italicized the courts’ statements that are particularly relevant to the matters under consideration. For ease of reference in class discussions, I have also italicized certain language in the documents, statutes, and regulations.

This book can be used for a two- or three-hour course. The heart of a course dealing with the legal aspects of corporate finance is set forth in Chapters two through five and a two-hour course can be based on those four chapters, with Chapter one utilized as introductory reading material; part of Chapter six can also be covered. A three-hour class can be taught from Chapters two through six, with Chapter one being used as the basis for an introductory lecture.

Richard T. McDermott

December 22, 2022

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2., Henry M. Hart and Albert M. Sachs, *The Legal Process* (tent. ed. 1958).

3., 1 Louis Loss *Securities Regulation* xiii (2d. ed. 1961).



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I would certainly be remiss if I did not thank my children, Richard Bissell McDermott and Christina Henderson as well as my grandchildren Palen, Carmel, and Peter McDermott and Maisie, Hutch, and Mac Henderson for their encouragement and support. My wife, Mary Pat McDermott, continues to make the countless sacrifices that the spouse of a lawyer necessarily and often inconveniently must endure. Her own participation in this process dates from her typing (and the now quaint use of carbon paper, cut-and-paste insertions and white-out) the countless drafts and revisions of my first legal publication: Note, *Taxation — Seller's Proceeds of "Bootstrap Sale" to Tax-Exempt Organization Held Taxable at Capital Gains Rates*, 34 FORDHAM L. REV. 358 (1965). Finally, I am most grateful to my father, Richard A. McDermott of the Wisconsin Bar, with whom I first traversed the legal thickets, and my mother Sylvia Portuondo McDermott.

