
TEACHING CORPORATE FINANCE

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I. INTRODUCTION

With projections that the demand for legal services will remain relatively flat in the post crisis period, legal service providers are placing greater emphasis on business and client development, and increasingly expect such efforts from their newest associates.¹ As language and culture can be the bridge or barrier to communication, lawyers who can speak the language and understand the business of clients will be in the best position to meet such expectations.² Here, we explore the role of corporate finance education in the law school curriculum in providing the requisite immersion and language instruction for corporate lawyers in training.

II. CORPORATE FINANCE IN THE LAW SCHOOL CURRICULUM

The broad outline of the corporate finance syllabus in the law school curriculum has remained relatively consistent since its introduction in the early 1940s.³ What has changed over time are the materials,

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1. Julie Savarino, *What Works to Develop New Business for Law Firms in the "New Normal"?*, BLOOMBERG BNA (Nov. 4, 2013), <http://www.bna.com/what-works-to-develop-new-business-for-law-firms-in-the-new-normal/>.

2. See, e.g., *Banking & Finance-Nationwide*, CHAMBERS & PARTNERS, <http://www.chambersandpartners.com/12788/6/Editorial/5/1> (last visited Oct. 1, 2014). Chambers Guide ranks the best law firms and lawyers by conducting in-depth telephone interviews with lawyers and clients. Banking & Finance clients praise firms for commercial awareness and commercial approach to matters.

3. For example, Professors Adolf A. Berle, Jr. and Roswell Magill in their 1942 textbook, *Cases and Materials in the Law of Corporation Finance*, describe the subject as including such concepts as valuation, debt and equity financing, and capital structures (the area of finance covering capital budgeting and structuring decisions of corporations and constituents). ADOLF A. BERLE JR. & ROSWELL MAGILL, *CASES AND MATERIALS IN THE LAW OF CORPORATION FINANCE* (2d ed. 1942). Seventy years later, today's Corporate Finance textbooks largely follow this structure. Professor William Bratton's *Corporate Finance* presents the corporate finance topic in five parts: valuation, debt financing, hybrid financing, equity financing, and mergers and acquisitions. WILLIAM BRATTON, *CORPORATE FINANCE* (7th ed. 2012). Professor Stephen Lubben's *Corporate Finance* is organized

methods, and motivations relied on to teach the topic of corporate finance. The next three decades witnessed the development of corporate law as it responded to new financial theories emerging over this period.⁴ For example, Professor William Bratton suggested responding to new developments in corporate finance by taking an integrated approach and blending scholarly materials with cases and statutes.⁵ Professor William Carney presents a finance-oriented approach to teaching the corporate finance topic, where students are first presented with the financial principles and then apply those principles to analyze and understand cases.⁶ In addition, Professor Richard Booth argued for a focus on finance and shareholder rights,⁷ and Professors Peter Huang and Michael Knoll placed special emphasis on the concept of capital structures, and their possibility of creating value.⁸ Thus, apart from agreeing on the core concepts, educators have taken widely differing views of how the topic ought to be approached.

The place of corporate finance within the broader law school curriculum has sometimes also been a quandary due to its specialized and technical nature, as well as its misfit with the traditional Socratic teaching method.⁹ Professor Andrew Hicks noted the misfit of corporate law principles with the traditional law school teaching methodologies.¹⁰ Professor Victor Fleischer echoed the concern that writing bench briefs and engaging in Socratic exercises did not equip students with the transactional skills required by modern corporate law practice.¹¹ In response to this perceived disconnect, Professor Robert Thompson proposes pre-conditioning students to this area of law by introducing cases which address shareholder rights and other business relationships earlier in the law school curriculum.¹²

Amid drastic changes to both the finance and regulatory landscapes in the post crisis period, now is an opportune moment to reevaluate the methods, materials, and motivations used in teaching corporate finance to this generation of corporate lawyers. While training lawyers for a spe-

around the four basic units of valuation, finance, mergers and acquisitions, and financial distress. STEPHEN J. LUBBEN, *CORPORATE FINANCE* (2013).

4. Roberta Romano, *After the Revolution in Corporate Law*, 55 J. LEGAL EDUC. 342, 345–46 (2005).

5. William W. Bratton, Jr., *Corporate Finance in the Law School Curriculum*, 1985 DUKE L.J. 237, 252.

6. WILLIAM J. CARNEY, *CORPORATE FINANCE: PRINCIPLES AND PRACTICE* (3d ed. forthcoming 2014).

7. Richard A. Booth, *A Minimalist Approach to Corporation Law*, 34 GA. L. REV. 431, 446 (2000).

8. Peter H. Huang & Michael S. Knoll, *Corporate Finance, Corporate Law and Finance Theory*, 74 S. CAL. L. REV. 175, 191–92 (2000).

9. J. G. Deutsch, *The Teaching of Corporate Law: A Socratic Investigation of Law and Bureaucracy*, 97 YALE L.J. 96, 97 (1987).

10. Andrew Hicks, *Teaching Modern Company Law—The Pint Pot*, 26 L. TCHR. 4, 4 (1992).

11. Victor Fleischer, *Deals: Bringing Corporate Transactions into the Law School Classroom*, 2002 COLUM. BUS. L. REV. 475, 478 (2002).

12. Robert B. Thompson, *Teaching Business Associations: Norms, Economics and Cognitive Learning*, 34 GA. L. REV. 997, 997–99 (2000).

cific area of practice has traditionally been the domain of legal employers, a recent Harvard study by Professors John Coates, Jesse Fried, and Kathryn Spier suggests that employers may be looking for students and schools to share some of this responsibility.¹³ The study reports that legal employers are strongly advising students to take certain courses while in law school, such as accounting and financial statement analysis and corporate finance,¹⁴ suggesting that graduates with such training can signal to employers' their interests and aptitude for this area of practice.¹⁵ Beyond this signaling effect, this brief Article considers how we can connect corporate finance theory with the practical skills demanded of corporate finance lawyers in this era.

III. BRIDGING THEORIES AND PRACTICE IN THE CLASSROOM

In this Part, we offer examples of how basic concepts in the corporate finance syllabus, such as time value of money, appraisals, and hedging can be used as a basis to practice the skills that are immediately applicable to corporate finance law practice. The guiding principle is to bridge the law or legal skill with finance concepts. Depending on the context, the law or legal skill may involve, for example, covenant review and drafting exercises, statute interpretation, due diligence, or correspondence with colleagues, clients, or opposing counsel.

A. *Time Value of Money*

Money has time value, where a dollar today is worth more than a dollar in the future. By how much more depends on how far away in the future and the applicable discount rate. To place this basic finance concept into the legal context, we present to our students a debt prepayment option. We describe a situation where a client with \$100 million in loans outstanding would like to negotiate with its lender an option to prepay at any time any amounts without penalty or premium. The relevant prepayment clause reads:

“The Borrower shall have the right to prepay at any time and from time to time without penalty or premium all or any part of the principal due. Each prepayment shall be applied to the principal installments _____.”

We ask students to consider the following three options with which to fill in the blank: (1) in the order of maturity, (2) in the inverse order of maturity, or (3) pro rata. Which option would our client prefer? The takeaway from the time value concept of money is that our client, the borrower, would prefer that the prepayment be applied in the order of

13. John C. Coates IV et al., *What Courses Should Law Students Take? Harvard's Largest Employers Weigh In 3* (HLS Program on the Legal Prof., Research Paper No. 2014-12, 2014), available at <http://ssrn.com/abstract=2397317>.

14. *Id.* at 2.

15. *Id.* at 5.

maturity—i.e., to amounts due earlier rather than later in time—since a dollar paid down today is worth more than that same dollar paid down tomorrow. On the other hand, lenders will tend to prefer to reduce the average life of loan, and thus would rather apply prepayments in the inverse order of maturity. One compromise would be to meet each other halfway and agree to apply the prepayment pro rata across all remaining installments. Often, lenders and borrowers will agree to vary the order of application depending on the source or amount of funds being used to prepay the debt.¹⁶ By situating the finance topic within a legal context in this way, we have found that students become more active participants in the concept being taught, and gain a practical perspective of its application.

B. *Appraisal Remedy*

Valuation is the keystone topic of the corporate finance syllabus. Both legal and financial asset valuations go to determining fundamental or intrinsic value.¹⁷ When legal and financial valuations systematically diverge from one another, this gap may suggest that the market or financial models under- or over-represent value to which the law attaches consequences. For example, the sales price of a firm represents the price at which the requisite percentage (e.g., majority) of owners are willing to sell, and may deviate significantly from the value placed on the same share by a minority shareholder who is opposed to a pending merger. In the latter case, market determined measures of value will systematically underestimate the valuation of the minority shareholder's investment. Legal rights can be relied upon to make up this gap, and the appraisal remedy is such a mechanism.

We study Delaware's version of the appraisal remedy, which is contained in Section 262 of the Delaware General Corporation Law ("DGCL"). Section 262 provides appraisal rights to shareholders objecting to a merger and requires the court to determine "the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation"¹⁸ In such determination, the court "shall take into account all relevant factors."¹⁹ We review the case law in this area to probe various components of Section 262, including fair value, expectation of the merger, and relevance. By combing through the factors that the court and appraiser consider in their determination of value, such as the nature of the enterprise, leverage, management, earnings and dividends, expenses of operation, and tax situation, students become familiar with how legal remedies rest on core concepts of finance.

16. RICHARD WIGHT ET AL., *THE LSTA'S COMPLETE CREDIT AGREEMENT GUIDE* 159–60 (2009) (describing allocation of prepayments).

17. BRATTON, *supra* note 3, at 3.

18. DEL. CODE ANN. tit. 8, § 262 (2013).

19. *Id.*

To “bringdown” the appraisal discussion to current practice, we discuss the recent trend in appraisal litigation where professional money managers are buying the stock of target companies in anticipation of a deal (or after a deal is announced but before the deal is completed) for the primary purpose of acquiring the option to exercise appraisal rights.²⁰ There are investment funds that have been formed for this specific purpose, where the explicit investment strategy of the fund is to identify opportunities where it can capitalize on premiums that may be earned from an appraisal proceeding.²¹ Against the backdrop of the expansive wording of Section 262, we round out the topic by discussing whether the identity or motivations of the dissenting shareholder exercising the appraisal right should be one of the factors that the court takes into account in its determination of fair value. This discussion provides an opportunity to become familiar with current topics in corporate finance as well as understanding the motivations and business of corporate clients.

C. Hedging

Most companies have a certain level of hedging (and in some cases, failure to hedge may constitute a breach of directors’ duties²²) that takes the costs required to administer the hedge netted against its expected returns into consideration. We have found that it is effective to first discuss the legal and regulatory concerns of hedging before relating it back to the financial mechanics and underlying instruments used to hedge risks. To do so, our focus is on the motivations behind those selling and buying the risks via the hedge, whether or not such risk shifting has societal value, and, if so, the role of laws and regulations in ensuring that such value is realized. What emerges from these discussions are the problematic aspects of hedging, which tend to detach the incentives to engage in due diligence from those who are in the best position to do so, as was evident from the rise of the originate-to-distribute model in the arranging of the mortgage-backed securities that were at the center of the recent financial crises. This raises interesting questions for the proper role of lawyers, when the boundary lines between legal and business diligence can become blurred at the initial structuring stages of corporate finance transactions.

Reviewing sections of the Dodd-Frank Act (which brings swaps under federal regulation to increase transparency and minimize default risks²³) and the Volcker Rule (which prohibits banks’ and other “systemically important financial companies” proprietary trading, and certain

20. See, e.g., WILSON SONSINI GOODRICH & ROSATI, THE GROWTH OF APPRAISAL LITIGATION IN DELAWARE 1 (2013), available at <http://www.wsgr.com/publications/PDFSearch/wsgralert-delaware-appraisal-litigation.pdf>.

21. *Id.*

22. See *Brane v. Roth*, 590 N.E.2d 587 (Ind. Ct. App. 1992).

23. *Dodd-Frank Act*, U.S. COMMODITY FUTURES TRADING COMM’N, <http://www.cftc.gov/lawregulation/doddfrankact/index.htm> (last visited Sept. 19, 2014).

relationships with hedge funds and private equity funds²⁴) is useful to students considering or decided on pursuing a career in the compliance area, as well as those who are pursuing more traditional roles in the private sector. With this legal and regulatory frame in mind, we turn to the underlying hedging instruments, such as forward contracts, futures contracts, swaps, and options.

IV. CONCLUSION

Increased competition among recent law graduates means that students interested in a specific field are seeking additional skills and means of specialization, which also tracks the increased specialization sought by employers.²⁵ Whether it be courses, memberships in organizations, clinics, research assistance positions, or internships and externships, there is a pervasive view among students that legal employers expect students to identify and credibly communicate their commitment to a particular practice area through skills and experience gained both inside and outside the classroom. In this brief Article, we highlight some ways in which law school classroom discussions can supplement the practical knowledge students gain from summer associateships and externships.

In our conversations with students and recent graduates enrolled in our Corporate Finance class, students repeatedly expressed the view that the topics covered in the Corporate Finance class were directly relevant to their desired area of future law practice.²⁶ When asked which topics or skills were expected to be the most relevant and helpful, several students pointed to the classes where covenant interpretation and hands-on financial analysis were covered.²⁷ Embedding students with the perspective that legal questions related to corporate finance are optimally answered by speaking the language of the client will prepare them for the current needs of the legal market. Bridging the law with finance concepts is an approach we have found to be effective in providing the students with the tools that Coates, Fried, and Spier's recent research suggests employers are looking for.²⁸

In their preparation for the road ahead, students were universally receptive to a teaching approach that brings together academic literature, law firm client memoranda, and case law for each topic. The materials and methods chosen have the dual benefits of not only offering a lens with which problems can be addressed, but also exposing students to a case study, which clearly highlights the business and legal motivations of

24. Justin Baer & Julie Steinberg, *Volcker Rule Challenges Wall Street*, WALL ST. J., Dec. 10, 2013, <http://online.wsj.com/news/articles/SB10001424052702303560204579249732841592834>.

25. Notes of conversations held on May 1, 2014 are kept on record with authors; the related conversation and feedback were recorded on April 9, 2014 with permission from participating students and kept on record by Aaron Birk.

26. *Id.*

27. *Id.*

28. Coates et al., *supra* note 13, at 3–4.

parties and offers a glimpse into the creative and applicable counseling, negotiating, and drafting strategies of corporate finance lawyers.

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