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Introduction

The purpose of this book is to consider and analyse UK corporate finance law. We consider the principles and policy behind the law in this area, and examine the substantive provisions in light of that discussion. In particular we aim to consider both the debt and equity aspects of corporate finance law, and the interrelationship between the two. Before stating in more detail what we aim to achieve, it might also be helpful to set out some of the things we don't seek to achieve. First, although we hope that this book will be read by practitioners, as well as academics, students and policy-makers, and that practitioners will find it interesting and useful, this is not predominantly a how-to guide for practitioners. We don't aim to put the reader in a position to be able to carry out in practice the corporate finance transactions described here. By way of example, the chapter dealing with takeovers (chapter fourteen) does not provide a step-by-step guide as to how to conduct a takeover in the UK. Rather it considers why jurisdictions generally regulate takeovers, why different jurisdictions regulate this issue in different ways, how the UK system compares to other jurisdictions (principally, in that chapter, the US) and then, once the aims of the UK regulation have been established, assesses the UK regulations against that background.

This raises another point, namely that while the book's focus is UK corporate finance law, other regimes are considered, and this comparative analysis can have a number of benefits. Some aspects of UK corporate finance law can only be understood if other regimes are discussed. For example, in a number of areas UK law is very heavily influenced by European developments. An obvious example of this are the disclosure requirements for prospectuses, discussed in chapters ten and thirteen. The Prospectus Directive,[1] a maximum harmonisation directive, and its accompanying Regulation,[2] provide the substance of the UK's disclosure requirements. At other points we examine other jurisdictions as a comparison with the UK provisions in order to provide fresh insight as to the suitability and utility of the UK provisions. This is not intended to be a comparative text, but examining other jurisdictions can help us to better understand domestic provisions. For example, much of the jurisprudence on the policy issues relating to security interests comes from the US, and notice filing schemes such as the ones in Canada and New Zealand are discussed in the context of reform of the UK law on secured transactions.

Although we have said that the purpose of this book is to consider and analyse UK corporate finance law, it must be remembered that the UK consists of four countries: England, Wales, Scotland and Northern Ireland. While the law of England and Wales is the same for all relevant purposes, there are often significant differences between English and Scots law, and some between Northern Irish law and English law. The differences are most notable

[1] 2003/71/EC, as amended by Directive 2010/73/EU.
[2] Commission Regulation (EC) No 809/2004, as amended.

with regard to non-statutory law, such as property law and contract. Scots law, especially, comes from a different origin (the civilian tradition) and resembles, in some respects, the law in some European countries, although in other respects it resembles the English common law.[3] However, virtually all company law which is statute based is the same for the whole of the UK.[4] The same is true of most of the regulation discussed in this book, particularly securities regulation, much of which is now derived from European legislation. Other statutory provisions, though, are different as regards English law and Scots law.[5] The reader therefore needs to be aware of this issue. In general, in the debt sections of the book, the law discussed is that of England and Wales, while in the equity sections generally what is said is true for the whole of the UK.

Another general point is that this book is not intended to be comprehensive in any sense. The term 'corporate finance' is not a term of art, and can mean very different things to different people. In deciding what to include we have started from our own conception of what 'corporate finance' means and what it includes, which may well be different from that of others. In part we have also been guided by our interests, but, having taught this subject for a number of years, we have also been guided by what interests and stimulates others about this topic. We will no doubt have included some topics that others do not consider need to be present in a book dealing with corporate finance law, and left out other topics that others would wish to have seen included.

It might be helpful, therefore, to explain what our conception of corporate finance entails. Our starting point is that corporate finance primarily concerns how a company can obtain money to finance its operations, and therefore corporate finance law consists of the legal rules that govern these issues. However, the term 'corporate finance law' is misleading to some extent since it is not one single body of law. Indeed, as will be clear on reading this book, the law described here includes, variously, general contract law, property law, company law and corporate insolvency law as well as more specialist regulatory law dealing with securities, takeovers and other issues. We restrict our analysis to the financing of companies limited by shares. We don't consider unlimited companies or companies limited by guarantee.[6] Neither do we cover the financing of limited liability partnerships, partnerships more generally, sole traders, charities, mutual funds, trusts or other similar structures.

In relation to the financing of companies, there are three basic sources of finance: share issues, debt and retained profits. To a large extent, therefore, we concentrate in this book on the mechanisms by which companies can raise equity capital, and what use they can make of that capital once it has been raised, and on the different methods by which they can raise debt financing. Debt financing is broadly defined, so as to include both loans and debt securities, and also other forms of credit such as trade credit extended to a company by other

[3] See P Wood, *Law and Practice of International Finance* (London, Sweet & Maxwell, 2008) 3-24–3-26.

[4] The Companies Act 2006 creates a single company law regime for the whole of the UK (see Companies Act 2006, Part 45) although some differences are preserved within the Act, such as the different regimes regarding derivative actions (Companies Act 2006, ss 260–64 for England, Wales and Northern Ireland and ss 265–69 for Scotland).

[5] For example, different parts of the Unfair Contract Terms Act 1977 (see eg 8.3.5.3) apply, on the one hand, to England, Wales and Northern Ireland, and, on the other hand, to Scotland, and s 136 Law of Property Act 1925 (see eg 9.2.2.2) applies only to England and Wales.

[6] Companies Act 2006, s 3.

companies. However, it does not include all the money of which the company makes use, for example money which is owed by the company to a third party and which the company uses to finance its operations in the interim. One example of this might be a third party who has a tort claim against the company; another is someone who has a claim in respect of defective goods purchased from a company.

Thus, for the purposes of this book, we concentrate on the category of creditors who lend money or extend credit to the company and whose intention is to finance the company's activities, rather than on those who are not intending to become creditors, even though they may have chosen to contract, or otherwise deal, with the company. The additional category of creditors (not lenders) highlighted here, such as tort claimants, is not our predominant concern. This does not mean that they will be ignored in this book. They are of importance in policy discussions, since the contractual arrangements entered into between creditor-lenders and the company can impact on them. In general they are in a weak position to protect themselves (for example if they are involuntary creditors) and so the question arises as to whether the law should step in to protect them. The term 'lender' is used throughout the book generically to include all those who consciously lend to or extend credit to a company. In this context, the company is called the 'borrower'.[7] However, when wider issues about the protection of all those to whom the company owes money are discussed, the term 'creditor' is used to include both lenders and others such as tort and breach of contract claimants.

Any regulation imposed by the law will impact on those groups that are within the contemplation of this book, that is, those who buy shares or consciously lend or extend credit to a company. Generally speaking, investors in shares are protected primarily by regulatory law, although their contractual relationships, in particular with the company or with other shareholders, can be important. By contrast, those who lend or extend credit to a company are protected largely by contractual or proprietary rights for which they bargain, and only by regulatory law in certain specific circumstances.

It follows from this that this book concentrates on companies that are raising finance via equity and debt financing. There are companies (banks and other finance companies) whose business is predominantly to lend money to others. We are not concerned with those types of companies and the topic of banking regulation falls outside the remit of this book. However, the financing of companies that extend credit to other companies is discussed at various points.

As regards the companies that do fall within the ambit of this book, it is clear that there is considerable variety in terms of both the size of companies and the business of those companies, and this necessarily impacts on their financing needs and options. One point which we want to make clear from the outset is that there is not a one-size-fits-all approach to financing which will suit all companies in all situations.

The business in which a company engages will have a significant impact on its financing choices. Companies may be categorised in terms of what they do—for example financial companies, real property companies, construction companies, manufacturing companies, retail companies, services companies, investment companies, or special purpose vehicles (SPVs), engaged, for example, in project finance or securitisation. The type of business

[7] These terms are used even when the transaction is structured somewhat differently, for example where receivables are sold to a receivables financier.

conducted by the company will be crucial in determining, for example, whether it has assets over which security can be taken, whether it will depend on trade credit, or whether lenders can make use of some of the quasi-security devices such as retention of title clauses. There is likely to be all the difference in the world between the financing profile of the archetypal company manufacturing and supplying widgets, a large listed pension fund company whose main business is investing in other companies, and an SPV set up to carry out a project finance operation. So, for example, a manufacturing company will have to raise finance to buy equipment and stock, as well as to meet employment and other running expenses. Its main assets will be tangible (land, equipment, stock) and intangible (receivables, maybe intellectual property and goodwill). It could be financed through loan finance, secured on its assets, or alternatively by asset-based finance, including receivables financing and retention of title finance in relation to the acquisition of equipment and stock. The listed pension fund company's assets will be equity and debt securities issued by other companies, and it will look to borrow in transactions using these as financial collateral. The project finance SPV will typically only have one asset, namely the revenue-generating contract, on the strength of which it will raise loan or bond finance. Another significant consideration might be whether the company operates within a group of companies and, if so, what role within the group that company performs.

As regards the size of companies, significant differences emerge according to whether the company in question is a private company or a publicly traded company, and whether it has a small group of shareholders who are heavily involved in the management of the company or a wide and dispersed shareholding profile. Consider, for example, a small private company which is effectively an incorporated sole trader. The shareholders and directors are likely to be the same people. As regards financing, it is likely that the director/shareholders will put in a relatively small amount of equity, and that the majority of the financing will be via loans either from the shareholder/directors and/or a bank. The primary purpose of shares in such a company is likely to be their control function rather than any capital raising device. Given the significant risk of insolvency for such a business, the bank will be very keen to protect against this eventuality. It is unlikely that the business itself will have significant assets, and usually the debts will be guaranteed by the director/shareholders personally and/or secured on their personal assets. In this situation, the relationship between the bank and the company is very important, and the bank will monitor the affairs of the company closely for signs of financial distress.

By contrast, in a somewhat larger private company, with some division between the shareholders and directors, shares become useful as finance-raising devices. However, the illiquidity of private company shares can make them unattractive as an investment, and therefore it may not be straightforward to persuade external investors to invest by way of share capital. One model is to seek a significant injection of equity capital from venture capital (discussed in chapter sixteen). The company is likely to still depend heavily on bank lending (an overdraft and maybe also a longer term loan) and again the bank will be keen to protect itself against the risk of insolvency by taking security (both fixed and floating charges) over the company's assets. The bank would decide to lend based on the previous and projected cash flow of the company, and there would still be an ongoing relationship between the bank and company, involving monitoring. However, such a company may also borrow using asset-based finance, where the amount lent is directly related to the amount of assets the company has. The assets may be sold to the lender (as in the case of receivables)

or the lender will take a charge, fixed if possible, over available assets. Depending on the nature of the company's business it may rely on financing supplied via trade creditors, customers etc.

Ultimately, for companies looking to increase significantly their levels of external equity finance, there is the option of issuing the company's shares to the public (discussed in chapter ten). An offer of shares to the public allows the company to have access to outside investors who can participate substantially in the company. This access to significantly increased levels of equity capital is one of the major advantages of offering shares to the public, especially when combined with a listing. Obtaining a listing for the shares creates liquidity. Not only is there a ready market for the shares, but they must be freely transferable.[8] An alternative equity funding option for larger companies is the leveraged buy-out model, whereby a private equity fund injects significant equity financing and purchases a majority stake in the company.[9] Larger companies, whether public or private, will raise debt finance from a number of lenders. Thus loan finance may come from a syndicate of banks, and the company may decide to issue debt securities to a selected number of financial institutions or, in rare instances, to the public. Both of these techniques, which enable the risk of non-payment to be spread across many parties and therefore enable more debt finance to be raised, are discussed in chapter eight. Liquidity is available from the free transferability of debt securities, and, to a more limited extent, from the ability of the lender to novate or assign a syndicated loan or to transfer the risk by other techniques. Transfer of debt is discussed in chapter nine.

A final, general point regarding the aims of this book relates to tax. We recognise that tax law is an important driver in many of the decisions which a company may take about its financing choices, and indeed in the investment decisions taken by investors. We seek to highlight those instances in which tax has a particular impact on these issues, but this is not a book about tax law, and specialist books should be consulted in this regard.[10]

In terms of the scheme of the book, and following on from this discussion, in chapter two we provide an overview of the financing options that are available to companies, which operates to some extent as a menu of financing options for companies. We consider the options for equity financing, debt financing, and financing via retained profits. Those options are then considered in more detail in later chapters of the book. One of the strengths of this book, we hope, is the fact that we consider both the debt and the equity side of the equation for companies, including the interrelationship of these forms of financing, and the mix of debt and equity financing which a company may choose: these issues are explored in chapter two and throughout this book. In chapter three we continue to look at both debt and equity financing side by side, but this time from the perspective of the providers of the finance. In particular, chapter three examines the role that shareholders and lenders play in both solvent and insolvent companies.

Chapter four examines the issue of shares by a company, and specifically the constraints placed on directors of all companies regarding their ability to raise capital in this way (for public offers of shares there are additional regulatory constraints that are discussed in

[8] FCA Handbook, LR 2.2.4(1).

[9] See chapter 16.

[10] See eg GK Morse and D Williams, *Principles of Tax Law*, 7th edn (London, Sweet & Maxwell, 2012); J Tiley and G Loutzenhiser, *Revenue Law*, 7th edn (Oxford, Hart Publishing, 2012).

chapters ten, eleven and twelve). The purpose of these constraints is assessed (most notably the need for shareholder protection), and the main restrictions placed on directors, namely pre-emption rights and the need for them to have authority to allot, are considered. Chapter five then examines the issue of legal capital. This can be regarded as an aspect of equity financing—that is, how companies can raise finance from the shareholders and what they can then do with the capital that has been raised. It can also be regarded as a creditor protection issue, namely as a mechanism for providing a fund of capital available to creditors in certain circumstances. In this latter sense, chapter five links naturally with chapters six and seven, which also deal with creditor protection issues. When creditors lend to the company they are exposed to the risk that the company will not pay ongoing obligations of interest, or, even more seriously, that the company will be unable to pay the entire capital sum advanced. Chapter five relates to creditor protection by rules concerning the share capital of a company, chapter six to creditor protection by contractual means (relating both to contracts with the borrowing company and to contracts with third parties), and chapter seven to creditor protection by proprietary means (including both absolute and security interests). As mentioned above, creditors receive little protection from regulation. One exception is where there is a conflict between the interests of shareholders and creditors: thus the preservation of share capital is heavily regulated by company law rules, although the utility of this regulation is doubtful, as chapter five explains. On the other hand, creditors can bargain for considerable protection by contract, limited only by the general rules of contract law, as explained in chapter six. The purpose of regulation in this area is largely to protect third parties, such as other creditors (who receive some protection by the insolvency rules as discussed in chapter three) and third parties who themselves give contractual protection, such as guarantors, who are also protected to some extent by common law principles. In addition, of course, there is quite extensive regulatory protection for holders of debt securities, in both the primary and secondary markets: this is discussed in chapter thirteen. The ability of creditors to bargain for proprietary protection is also fairly unlimited, as explained in chapter seven: such regulation as there is relates largely to the protection of other creditors, and includes the requirement to register security interests, some protection from insolvency law (discussed in chapters three and seven) and rules relating to general property law.

Chapters eight and nine discuss more specific aspects of debt financing. Chapter eight discusses the problems that arise when there are multiple lenders, in terms of both organisational structure and decision-making procedures. The various techniques used to transfer debt, such as novation and assignment, are discussed in chapter nine. The chapter also considers the application of these legal techniques to loan transfers, the transfer of receivables and the transfer of debt and equity securities, as well as the transfer of the risk of debt by techniques such as securitisation and loan participation.

Chapters ten, eleven and twelve then return to equity financing issues. Chapter ten considers the issue of initial public offers for shares, discussing why companies might wish to float their shares on a public market, and why and how the law regulates this issue, in terms of both ex ante disclosure requirements and ex post enforcement mechanisms. Chapters eleven and twelve consider the next stage, namely the regulation of the secondary market. Chapter eleven examines the use of disclosure rules to regulate the secondary market, and in chapter twelve the use of rules designed to deal with market misconduct (such as market manipulation and short selling) is discussed. In each case both the ex ante and the ex post

aspects of the regulatory regime are considered. Chapter thirteen returns to debt financing, but continues the themes of chapters ten to twelve by examining the regulation of the debt markets.

Chapters fourteen and fifteen consider a slightly different aspect of equity financing. Issuing shares is an important mechanism for raising finance, but holding shares in a company, particularly ordinary shares, provides the holder with voting rights, in addition to income and capital rights. As a result, holding shares has important consequences for the exercise of control within the company, and transferring shares can effect a change of control within a company. In these chapters we therefore consider two mechanisms for transferring control in a company via a transfer of shares. Takeovers are considered in chapter fourteen, and schemes of arrangement in chapter fifteen. These mechanisms are often used to achieve the same ends, and are seen as alternatives, but they operate in quite different ways. Schemes of arrangement are also used to rearrange a company's capital in other ways, and another common use of schemes is to reorganise the relationship between a company and its creditors, especially where the company is in financial distress. This use of schemes is also discussed in chapter fifteen.

Finally, in chapter sixteen, private equity transactions are examined. The growth of private equity as a mechanism for financing companies is considered, as is the content of a typical private equity transaction. Private equity grew enormously in the UK in the period up to 2008, to the point where it was said to rival the public markets as a source of financing in the UK. A comparison of private equity backed companies and publicly traded companies is undertaken in this chapter with a view to understanding this phenomenon, although it has been relatively rare in practice since the financial crisis. The increasing regulation of the private equity industry post-crisis is also considered in this chapter.

When the first edition of this book was written in 2010, the effects of the global financial crisis on the ways in which non-financial companies raised finance were considered. Two effects, in particular, were noted. The first was the severe reduction of available bank finance for all sorts of companies, and the second was the increase in regulation designed to ameliorate systemic risk. Nearly five years further on, the ramifications of the financial crisis continue to be felt. Although the equity and debt markets have largely recovered from the immediate aftermath of the crisis, the effects noted above still persist. There is still a lack of debt finance available from banks, and alternative providers have stepped in to fill the gap, often involving financing techniques other than straight loans.[11] There has been an enormous increase in regulation, with many of the changes being introduced by the EU, which has responded to the crisis both by following the global agenda of stability laid down by G20[12] and also by reforming its own regulatory regime in order to advance its goal of a single financial market.[13] It remains to be seen how much these regulatory changes have affected the raising of finance by non-financial companies, for example by increasing costs.

[11] See 2.3.1.1 and 2.3.1.2.

[12] This includes the regulation of short selling (see 12.3), of credit rating agencies (see 13.7), of alternative investment fund managers (16.7) and of the derivatives markets (see 6.4.3), as well as reforming the capital requirements regime (see 2.3.1.4).

[13] Such reforms include significant changes to the market abuse regime (see 12.2) and to the disclosure regime (see 11.3), but the scale of the change is enormous and almost no chapter of this edition is unaffected by the regulatory reforms. For discussion see Moloney: EU Regulation, 1.5; J Payne and E Howell, 'The Creation of a European Capital Market' in P Koutrakos and J Snell (eds), *Research Handbook on the Law of the EU's Internal Market* (Cheltenham, Edward Elgar, 2015).