

**CORPORATE  
FINANCE**  
**PRINCIPLES AND PRACTICE**  
**SECOND EDITION**

**WILLIAM J. CARNEY**

**FOUNDATION PRESS**

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# CORPORATE FINANCE:

PRINCIPLES AND PRACTICE

SECOND EDITION

*by*

WILLIAM J. CARNEY

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Emory University



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*To Jane*

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## PREFACE TO THE SECOND EDITION

Teaching corporate finance in a law school is one of the more challenging pedagogical tasks confronting law teachers. There are too many choices confronting the teacher in this area, and none seems obviously superior to the others. A course can be law-oriented or finance-oriented. Among the difficulties with the law-oriented course is that it, too, faces choices—which body of law? The traditional approach has been case law—appellate decisions applying legal principles are a safe and conventional choice. One difficulty with the case-law approach is that so much of corporate finance is simply contractual—constructing agreements that resolve the tensions between parties, such as the stockholder-bondholder conflict. Leading cases in some areas are simply old—these areas became settled law with the first authoritative pronouncement, after which drafters conformed their behavior to the announced rules. The other difficulty is that this approach gives little attention to the law as it is practiced—in deals and in documents. This book leans toward the deal side, particularly in the area of corporate debt and convertible securities. Contractual language should be seen and experienced.

Some casebooks in this field spend a good deal of time on the problems facing common stockholders, including the fiduciary duties from which shareholders benefit. While these are important, they are not emphasized here, in the expectation that they are covered in basic corporation courses, or in other courses such as mergers & acquisitions. Accordingly, there are no chapters on mergers and acquisitions in this book. The focus here (aside from finance) is on the contracting issues facing investors, from dilution of existing shareholders to imposition of greater risk on creditors.

The other difficulty with concentrating on the law is that it provides students with little theory about or understanding of the problems they are addressing when they function as transactional lawyers. Students approaching this course with a search for an overarching body of legal principles may be disappointed. The principles were found largely in their contracts course and to some extent in their corporations course. Here finance must play an organizing role. That is the approach of this book. My goal is that students will understand their clients' problems and see how standard drafting is designed to solve them.

Some teachers have employed finance textbooks addressed to business students to achieve this goal. Readings from this text are supplemented with cases and other materials prepared by the teacher. While I am sympathetic to this approach, I have never employed it, for several reasons. First, the finance is sometimes more technical than many law students are prepared for, which may limit enrollments to those with a prior background

in finance or a strong taste for mathematics. Second, these texts are generally aimed at students who will make investment decisions within firms, which is not the focus best suited to law students. Third, the links between the finance theory and the cases may be harder to see, because the text authors had another audience in mind. This book is at least in part addressed to those teachers—I offer an alternative of less extensive (and less mathematical) discussion of finance problems and a greater integration with legal materials. At the same time, I hope the book is not intimidating to law teachers with less interest in the application of finance principles. Rather than use excerpts from the finance literature, in many cases I have attempted to present finance principles in my own words, in the hope that this presentation, with the law student reader in mind, may be somewhat more accessible if somewhat less technical.

I have retained the basic organizational approach in this edition, and aside from clean-up of obvious errors in the first edition, simply updated the materials where appropriate.

The book begins with an accounting chapter that inquires how we measure the output of a business. The approach here is to help students without an accounting background understand how to read financial statements, and how ratios can be used to evaluate the health of a business. Obviously accurate statements of earnings and cash flows are essential for the valuation material in Chapter Three. This accounting material re-emerges in the debt chapter, where covenants are frequently based on these same ratios. The book then proceeds to questions of how we maximize that value. Here contracting, on both common and preferred stock, as well as on debt, plays a critical role. I hope this will give students an understanding of the role that lawyers play in helping our economy create value, and an appreciation of the importance of their own role in that process.

Consistent with that approach, each chapter and each section generally begins with the finance theory, and only then proceeds to the cases. There are problems and questions to test students' understanding of the finance theory, but probably not as many as teachers accustomed to using a finance text might wish. Finally, the book places relatively more emphasis on contracting than other books, with generous samples of indenture language coupled with the discussion of finance theory. Hence the relevance of the title, "Principles and Practice."

As is customary in casebooks, I have taken certain liberties with judicial opinions. Citations are omitted without indication. Editing has removed sections of opinions important to the individual case but not to the pedagogical mission of this book. Formatting of headings follows a consistent approach in the book, which often will not be identical to the formatting in the original opinion.

WILLIAM J. CARNEY

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# **CORPORATE FINANCE:**

**PRINCIPLES AND PRACTICE**

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