

WHAT IS A CORPORATION

A corporation is a legal form of business organization defined by five core structural characteristics:

- **Legal personality** – The corporation is recognized as a separate legal entity that owns assets, enters contracts, and can sue or be sued independently of its shareholders.
- **Limited liability** – Shareholders are liable only up to the amount of their investment; their personal assets are protected from the corporation's creditors.
- **Transferable shares** – Ownership interests (shares) can be transferred without disrupting the corporation's existence or operations, enabling liquidity and investment flexibility.
- **Delegated management under a board structure** – Control over the firm's affairs is delegated to a board of directors, which oversees management and acts on behalf of shareholders.
- **Investor ownership** – Ownership rights, including voting and profit claims, are allocated to investors in proportion to the capital they contribute.

LEGAL PERSONALITY

- a) **NEXUS OF CONTRACTS / NEXUS FOR CONTRACTS**
- b) **creation of a single contracting party**
- c) **separate patrimony (functions)**

LEGAL PERSONALITY

A) ENTITY SHIELDING (creditors of entity's owners cannot seize the separate patrimony)

A1) PRIORITY RULE (entity's creditors are preferred)

A2) LIQUIDATION PROTECTION RULE (keeping steady the going concern of the business, preventing owners from withdrawing - and their creditors from foreclosing – the owner's share of the company assets)

With regard to the liquidation protection rule:

- i. *Corporations have a STRONG-FORM ENTITY SHIELDING*
- ii. *Partnerships have a WEAK-FORM ENTITY SHIELDING*

LEGAL PERSONALITY

B) rules specify the **INDIVIDUALS WITH AUTHORITY TO ACT ON BEHALF OF THE CORPORATION**

C) procedures fix the **CAPACITY** of the entity **TO SUE** and **TO BE SUED** with regard to lawsuits

N.B.: These 3 rules must be provided by law as the contracting power is not enough to gain such outcomes

LIMITED LIABILITY

It is a strong form of OWNERS SHIELDING (opposite of entity shielding), preventing the firm's creditors from enforcing their claims against shareholders

A) ASSET PARTITIONING functions:

- Lowers costs of monitoring
 - Reduces overall cost of capital to firms and owners
 - Permits firms to insulate different line of business
 - Shares risks of transactions among creditors
 - Allows a better allocation of risks and returns
 - Facilitates delegated management
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- LIMITED LIABILITY *in contract*
 - LIMITED LIABILITY *in tort* is not a necessary feature of the corporate form (protection of non-adjusting creditors)

TRANSFERABLE SHARES

FULLY TRANSFERABLE SHARES to be seen as basic feature of corporations

Transferability of the shares constitutes a relevant EXIT STRATEGY to owners which does not put at risk the going concern of the corporation as it would be with a shareholders withdrawal (case of partnership)

FULLY TRANSFERABLE DOES NOT MEAN FREELY TRADABLE shares

OPEN/PUBLIC corporations have freely transferable shares

CLOSED/PRIVATE corporations have restrictions on share tradability

open/public corporation

- listed/publicly traded vs. unlisted

corporation shares

- closely held vs. widely held

DELEGATED MANAGEMENT

Management power cannot be given to shareholders like in partnership (expl. coordination costs)

Authority over corporate affairs is vested to a board of directors

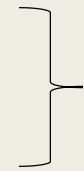
4 basic features:

- a) separate from the operational management as hired officers (different competence between board and officers)
- b) elected by shareholders
- c) distinct from shareholders
- d) multiple members

INVESTOR OWNERSHIP

RIGHT TO CONTROL the FIRM

RIGHT TO RECEIVE EARNINGS



proportional to the capital contribution

Other forms of ownership: in cooperatives. voting power and earnings are proportional to act of patronage; in partnerships, ownership can go to contributors of labor, etc.

N.B. INVESTOR OWNERSHIP IS THE DEFAULT RULE FOR CORPORATIONS

EXCEPTIONS:

- HIGH TECH START UP
- Bcorp
- CREDITORS/WORKERS Codetermination
- State owned enterprises
- nonprofit firms