

KEY POINTS

CERTIFICATE COURSE INTRODUCTION TO CORPORATE FINANCE

MODULE 1 – INTRODUCTION TO CONCEPTS IN FINANCE

AN OVERVIEW OF ETHICS

- Ethical behavior is based on written and unwritten codes of principles and values held in society.
- Ethics reflect beliefs about what is right, what is wrong, what is just, what is unjust, what is good, and what is bad in terms of human behavior.
- Ethical principles and values serve as a guide to behavior on a personal level, within professions, and at the organizational level.

ETHICS TRAINING

- There are four components of moral behavior: moral sensitivity, moral judgment, moral motivation, and moral character.
- To make moral assessments, one must first know what an action is intended to accomplish and what its possible consequences will be on others.
- Studies have uncovered four skill sets that play a decisive role in the exercise of moral expertise: moral imagination, moral creativity, reasonableness, and perseverance.

CULTURE AND ETHICS

- Culture refers to the outlook, attitudes, values, goals, and practices shared by a group, organization, or society.
- Interpretation of what is moral is influenced by cultural norms, and different cultures can have different beliefs about what is right and wrong.
- According to the theory of cultural relativism, there is no singular truth on which to base ethical or moral behavior, as our interpretations of truths are influenced by our own culture.

THE MANAGER'S ROLE IN ETHICAL CONDUCT

- Personal values provide an internal reference for what is good, beneficial, important, useful, beautiful, desirable, and constructive.
- Personal values take on greater meaning in adulthood as they are meant to influence how we carry out our responsibilities to others.
- To make ethical and moral choices, one needs to have a clear understanding of one's personal values.

BLURRING ETHICAL LINES

- Identifying the ethical choice can be difficult since many situations are ambiguous and facts are subject to interpretation.
- In organizations, employees can look to the code of ethics or the statement of values for guidance about how to handle ethical gray areas.
- Individual ethical judgment can be clouded by rationalizations to justify one's actions.

INVESTMENT AND FINANCING

- The primary goal of both investment and financing decisions is to maximize shareholder value.
- Investment decisions revolve around how to best allocate capital to maximize their value.
- Financing decisions revolve around how to pay for investments and expenses. Companies can use existing capital, borrow, or sell equity.

INSTITUTIONS, MARKETS, AND INTERMEDIARIES

- Financial intermediaries provide access to capital.
- Banks convert short-term liabilities (demand deposits) into long-term assets by providing loans; thereby transforming maturities.
- Through diversification of loan risk, financial intermediaries are able to mitigate risk through pooling of a variety of risk profiles.

STOCK MARKETS

- Pension funds are important shareholders of listed and private companies.
- Insurance companies are generally classified as either mutual or proprietary companies.
- A mutual fund is a type of professionally-managed collective investment vehicle that pools money from many investors to purchase securities.
- An index fund or index tracker is a collective investment scheme (usually a mutual fund or exchange-traded fund) that aims to replicate the movements of an index of a specific financial market, or a set of rules of ownership that are held constant, regardless of market conditions.
- An exchange-traded fund (ETF) is an investment fund traded on stock exchanges, much like stocks.
- A hedge fund is an fund that can undertake a wider range of investment and trading activities than other funds. It is generally only open to certain types of investors specified by regulators.

NYSE

- The origin of the NYSE can be traced to May 17, 1792, when the Buttonwood Agreement was signed by 24 stockbrokers outside of 68 Wall Street in New York under a buttonwood tree on Wall Street.
- The New York Stock Exchange (sometimes referred to as "the Big Board") provides a means for buyers and sellers to trade shares of stock in companies registered for public trading.
- The New York Stock Exchange is open for trading Monday through Friday from 9:30 am to 4:00 pm ET, with the exception of holidays declared by the NYSE in advance.
- Traders can gather around the appropriate post. There, a specialist broker acts as an auctioneer in an open outcry auction market environment to bring buyers and sellers together and to manage the actual auction.
- To be listed on the New York Stock Exchange, a company must have issued at least a million shares of stock worth \$100 million and must have earned more than \$10 million over the last three years.

NASDAQ

- NASDAQ was founded in 1971 by the National Association of Securities Dealers (NASD), who divested themselves of it in a series of sales in 2000 and 2001.
- NASDAQ quotes are available at three levels: Level 1 shows the highest bid and lowest offer; Level 2 shows all public quotes of market makers; Level 3 is used by the market makers and allows them to enter their quotes and execute orders.
- NASDAQ has a pre-market session from 7:00 am to 9:30 am, a normal trading session from 9:30 am to 4:00 pm, and a post-market session from 4:00 pm to 8:00 pm (all times in ET).
- Three market tiers are NASDAQ Capital Market – Small Cap, NASDAQ Global Market – Mid Cap, NASDAQ Global Select Market – Large Cap.

MARKET REPORTING

- The market index is a tool used by investors and financial managers to describe the market and to compare the return on specific investments.
- An index is a mathematical construct, so it may not be invested in directly.
- A 'world' or 'global' stock market index includes (typically large) companies without regard for where they are domiciled or traded.
- A 'national' index represents the performance of the stock market of a given nation—and by proxy, reflects investor sentiment on the state of its economy.
- Stock market indices provide invaluable information for investors and accountants.

DEFINING STOCK

- The stock (capital stock) of a company or business entity is equal to the original capital paid into the business by its founders.
- Stock serves as a security for creditors and investors in the business. While it may fluctuate in value, it is different from the assets and property of a business.
- A shareholder legally owns share of a stock in a public or private corporation, and has certain rights with regards to the company because of share ownership.

CONTROL AND PREEMPTION

- Shareholders gain certain rights with regards to a business entity when purchasing stock. These include being able to sell shares, voting rights and dividends.
- Shareholders have the right of preemption, meaning they have the first chance at buying newly issued shares of stock before the general public.
- Even if shareholders do have the option of using their preemptive right, they do not have to exercise it.

TYPES OF STOCK

- Common stock is a form of equity ownership. It is a type of security that is also known as a voting share or an ordinary share.
- Common stock shareholders will not receive assets after bankruptcy unless the bondholders, other creditors, and preferred shareholders are paid first. Common shareholders also do not get dividends unless preferred shareholders receive them first.
- Common shareholders do receive voting rights. Some shareholders may also be able to exercise preemptive rights.

PREFERRED STOCK

- Preferred stock is a security which has characteristics of both equity and debt securities.
- Preferred stock shareholders have rights to dividends and assets (in the case of bankruptcy) before Common stock shareholders.
- Preferred stockholders have a number of rights which will vary based on the business entity, but generally do not carry voting rights.

RULES AND RIGHTS OF COMMON AND PREFERRED STOCK

- Common stock and preferred stock are both forms of equity ownership but carry different rights and claims to income.
- Preferred stock shareholders will have claim to assets over common stock shareholders in the case of company liquidation.
- Preferred stock also has first right to dividends.

VOTING RIGHT

- Common stock shareholders can generally vote on issues, such as members of the board of directors, stock splits, and the establishment of corporate objectives and policy.
- While having superior rights to dividends and assets over common stock, generally preferred stock does not carry voting rights.
- Many of the voting rights of a shareholder can be exercised at annual general body meetings of companies. An annual general meeting is a meeting that official bodies, and associations involving the general public, are often required by law to hold.

PURCHASING NEW SHARES

- New share purchase is an important indicator of current shareholder belief in the health of the company and long term prospects for growth.
- Current Shareholders will often have preemptive rights that give them the right to purchase newly issued company shares before they go on sale to the general public.
- New shares can be purchased on exchanges, which offer a platform for the financial marketplace.

PREFERRED STOCK RULES AND RIGHTS

- Preferred stock generally does not carry voting rights, but this may vary from company to company.
- Preferred stock can gain cumulative dividends, convertibility to common stock, and callability.
- The rights that come with ownership of preferred stock are detailed in a "Certificate of Designation".

PROVISIONS OF PREFERRED STOCK

- If a preferred share has cumulative dividends, then it contains the provision that should a company fail to pay out dividends at any time at the stated rate, then the issuer will have to make up for it as time goes on.
- Convertible preferred stock can be exchanged for a predetermined number of company common stock shares.
- Often times companies will keep the right to call or buy back preferred shares at a predetermined price.
- Participating preferred issues offer holders the opportunity to receive extra dividends if the company achieves predetermined financial goals.
- Sometimes, dividends on preferred shares may be negotiated as floating; they may change according to a benchmark interest-rate index.

COMPARING COMMON STOCK, PREFERRED STOCK, AND DEBT

- Common stock and preferred stock fall behind debt holders as creditors that would receive assets in the case of company liquidation.
- Common stock and preferred stock are both types of equity ownership. They receive rights of ownership in the company, such as voting and dividends.
- Debt holders often receive a bond for lending and while this does not give the ownership rights of being a stockholder, it does create a superior claim to a company's assets in the case of liquidation.

EQUITY FINANCE

- The equity, or capital stock (or stock) of a business entity represents the original capital paid into or invested in the business by its founders.
- Shares represent a fraction of ownership in a business. A business may declare different types or classes of shares, each having distinctive ownership rules, privileges, or share values.
- In finance, the cost of equity is the return (often expressed as a rate of return) a firm theoretically pays to its equity investors, (i.e., shareholders), to compensate for the risk they undertake by investing their capital.

STOCK VALUATION

- Companies generally either retain earnings for investment, or distribute them as dividend, according to their growth strategy.
- Clientele effects suggests that different dividend levels attract different types of investors.
- Value investors look for indications that a stock is undervalued. High dividends are one indication of undervaluation.
- Knowing a firm's cost of capital is needed in order to make better decisions. Managers make capital budgeting decisions while capital providers make decisions about lending and investment.

EXPECTED DIVIDENDS AND CONSTANT GROWTH

- Companies are constantly changing, as well as the economy. Solely using historical growth rates to predict the future is not an acceptable form of valuation. Calculating the future growth rate requires personal investment research.
- A generalized version of the Walter model (1956), SPM considers the effects of dividends, earnings growth, as well as the risk profile of a firm on a stock's value.
- The Gordon model or Gordon's growth model is the best known of a class of discounted dividend models. It assumes that dividends will increase at a constant growth rate (less than the discount rate) forever.

RELATIONSHIP BETWEEN DIVIDENT PAYMENTS AND THE GROWTH RATE

- Investors take into account how much capital is distributed to investors, and conversely how much capital is kept from investors.
- Investors hope that firms will use retained earnings to either maximize their current operations or invest in such as a way as to lead to higher profits.
- Some firms are unable to distribute earnings, since their funds are tied up in maintenance, repairs, et cetera.
- On the other hand, some companies can retain earnings and put that money back to work - i.e., invest in growth opportunities.

UNDERSTANDING FUTURE STOCK VALUE

- Earnings Per Share is the total net income of the company divided by the number of shares outstanding; the Profits/Earnings ratio is the stock price divided by the annual EPS figure.
- Return on Invested Capital measures how much money the company makes each year per dollar of invested capital and approximates the expected level of growth; Return on Assets measures the company's ability to make money from its assets.
- To measure Market Capitalization (the value of all of a company's stock), multiply the current stock price by the fully diluted shares outstanding; Enterprise Value is equal to the total value the company is trading for on the stock market.
- Enterprise Value (EV) to earnings before interest, taxes, depreciation and amortization (EBITDA) is one of the best measurements of whether or not a company should be valued as cheap or expensive.

VALUING NONCONSTANT GROWTH DIVIDENDS

- Limited high-growth approximation: When a stock has a significantly higher growth rate than its peers, it is sometimes assumed that the earnings growth rate will be sustained for a short time (say, 5 years), and then the growth rate will revert to the mean.
- Implied Growth Models: One can use the Gordon model or the limited high-growth period approximation model to impute an implied growth estimate.
- Imputed growth acceleration ratio: Subsequently, one can divide this imputed growth estimate by recent historical growth rates.

VALUING THE CORPORATION

- Income approaches include Discount or capitalization rates, Capital Asset Pricing Model (CAPM), Modified Capital Asset Pricing Model, and Weighted average cost of capital ("WACC").
- The asset approach to business valuation is based on the principle of substitution: no rational investor will pay more for the business assets than the cost of procuring assets of similar economic utility.
- The market approach to business valuation is rooted in the economic principle of competition: in a free market the supply and demand forces will drive the price of business assets to a certain equilibrium.

DISCOUNTED DIVIDEND VS. CORPORATE VALUATION

- $P = D1 / (r - g)$. P is the current stock price, g is the constant growth rate in perpetuity expected for the dividends, r is the constant cost of equity for that company, and D1 is the value of the next year's dividends.
- The equation can also be understood to generate the value of a stock such that the sum of its dividend yield (income) plus its growth (capital gains) equals the investor's required total return.
- There are also problems with the model, such as the presumption of a steady and perpetual growth rate less than the cost of capital may not be reasonable.

THE SECURITY MARKETS

- An initial public offering (IPO), or stock market launch, is a type of public offering where shares of stock in a company are sold to the general public, on a securities exchange, for the first time.
- A secondary market offering is a registered offering of a large block of a security that has been previously issued to the public.
- In the secondary market, securities are sold by and transferred from one investor or speculator to another. It is therefore important that the secondary market remain highly liquid.
- Private placement (or non-public offering) is a funding round of securities which are sold not through a public offering, but rather through a private offering, mostly to a small number of chosen investors.
- Stock repurchase (or share buyback) is the reacquisition by a company of its own stock.

TYPES OF MARKET ORGANIZATIONS

- The primary market is that part of the capital markets that deals with the issue of new securities.
- Over-the-counter (OTC) or off-exchange trading is to trade financial instruments such as stocks, bonds, commodities, or derivatives directly between two parties.
- The secondary market, also called aftermarket, is the financial market in which previously issued financial instruments such as stock, bonds, options, and futures are bought and sold.
- One type of market structure is the auction market, where buyers and sellers are brought together directly, announcing the prices at which they are willing to buy or sell securities.
- Broker markets are usually only used for securities that have no public market, necessitating the middleman in the form of a broker. The broker works for a client to find a suitable trading partner.
- Dealer markets, also called quote-driven markets, centers on market-makers (or dealers) who provide the service of continuously bidding for securities that investors want to sell and offering securities that investors want to buy.

UNDERSTANDING RETURNS

- Realized returns involve the sale of the asset while unrealized returns are based off of changes in the market value, but not a sale.
- Realized returns are taxed, while unrealized returns are not.

- When the value of an asset is based off of the market value at the end of the reporting period, the company is using the mark-to-market valuation method.

DOLLAR RETURNS

- Dollar returns do not take into account things like the time value of money or the time frame of the investment.
- In security markets, the dollar return of the security is the difference in the final market price and the market price at which it was purchased.
- Dollar returns are useful for determining the nominal amount that the firm's assets will change.

PERCENTAGE RETURNS

- Total percentage returns divide the dollar returns by the initial value of the investment. This is also the return on investment (ROI).
- Annual returns show the percentage by which the value of the asset changes in each individual year.
- Average annual percentage returns can be calculated by dividing ROI by the number of years, or by other methods such as the compound annual growth rate (CAGR) or internal rate of return (IRR).

HISTORICAL RETURNS: MARKET VARIABILITY AND VOLATILITY

- Historical returns do not guarantee future returns.
- All markets have a degree of systemic risk which means that they have a risk of collapsing due to external factors. Companies are also interconnected, so the failure of one company can have far-reaching effects.
- "Animal spirits" describes general investor sentiment which can affect markets, even without changes in the underlying financials.

CALCULATING AND UNDERSTANDING AVERAGE RETURNS

- Average return on investment (ROI) is the arithmetic average of the total cash returns divided by the initial investment. It is useful for quick calculations and specific securities (such as bonds purchased at par), but does not account for compounding returns.
- Compound annual growth rate (CAGR) is derived from the future value formula with compounding interest. It accounts for compounding returns.
- Internal rate of return (IRR) is the discount rate at which the NPV equals 0. It is used because it allows for easy comparison between investment options and is easy to understand.
- For all three methods, the higher the average rate of return, the more attractive the investment is.

MARKET EFFICIENCY

- The efficient-market hypothesis (EMH) asserts that financial markets are "informationally efficient. " As a result, one cannot consistently achieve returns in excess of average market returns on a risk-adjusted basis, given the information available at the time the investment is made.
- Historically, there was a very close link between EMH and the random-walk model and then the Martingale model. The random character of stock market prices was first modelled by Jules Regnault, a French broker, in 1863.
- The definitions for three forms of financial market efficiency: weak, semi-strong, and strong.

THE EFFICIENT MARKET HYPOTHESIS

- In weak-form efficiency, future prices cannot be predicted by analyzing prices from the past.
- In semi-strong-form efficiency, it is implied that share prices adjust to publicly available new information very rapidly and in an unbiased fashion, such that no excess returns can be earned by trading on that information.

- In strong-form efficiency, share prices reflect all information, public and private, and no one can earn excess returns.

IMPLICATIONS AND LIMITATIONS OF THE EFFICIENT MARKET HYPOTHESIS

- Empirical evidence has been mixed, but has generally not supported strong forms of the Efficient Market Hypothesis.
- Speculative economic bubbles are an obvious anomaly in that the market often appears to be driven by buyers operating on irrational exuberance, who take little notice of underlying value.
- Any anomalies pertaining to market inefficiencies are the result of a cost benefit analysis made by those willing to incur the cost of acquiring the valuable information in order to trade on it.
- The financial crisis of 2007–2012 has led to renewed scrutiny and criticism of the hypothesis, claiming that belief in the hypothesis caused financial leaders to adopt a "chronic underestimation of the dangers of asset bubbles breaking".

MARKET REGULATION

- The 1933 Act's objectives are to provide investors with material financial and other corporate information about issuers of public securities.
- The primary purpose of the 1933 Act is to ensure that buyers of securities receive complete and accurate information before they invest.
- Among other things, registration forms call for: a description of the securities to be offered for sale; information about the management of the issuer; information about the securities (if other than common stock); and financial statements certified by independent accountants.
- Rule 144, promulgated by the SEC under the 1933 Act, permits, under limited circumstances, the sale of restricted and controlled securities without registration.
- Regulation S is a "safe harbor" that defines when an offering of securities is deemed to be executed in another country and therefore not be subject to the registration requirement under section 5 of the 1933 Act.

SECURITIES EXCHANGE ACT OF 1934

- The Securities Exchange Act of 1934 is a law governing the secondary trading of securities in the United States of America. The Act and related statutes form the basis for the regulation of the financial markets and their participants in the United States.
- One area subject to 34 Act regulation is the actual securities exchange: New York Stock Exchange, the American Stock Exchange, and regional exchanges like the Cincinnati Stock Exchange, Philadelphia Stock Exchange and Pacific Stock Exchange.
- The '34 Act also regulates broker-dealers without a status for trading securities. A telecommunications infrastructure was developed to provide for trading without a physical location.
- In 1938 the Exchange Act was amended by the Maloney Act, which authorized the formation and registration of national securities associations to supervise the conduct of their members subject to the oversight of the SEC.
- In the last 30 years, brokers have created two additional systems for trading securities. The alternative trading system, or ATS, is a quasi exchange where stocks are commonly purchased and sold through a smaller, private network of brokers, dealers, and other market participants.

SECURITIES ACTS AMENDMENTS OF 1975

- The 1975 amendments, also called the National Exchange Market System Act, directed the securities and exchange commission to work with the industry toward establishing a national market system together with a system for the nationwide clearance and settlement of securities transactions.
- The National Market System (NMS) is the national system for trading equities in the United States.

- A national market system plan (or NMS plan) is a structured method of transmitting securities transactions in real-time.
- In 2005, the rules promoting the national market system were consolidated into REG NMS.
- The order protection rule has generated controversies since it requires traders to transact on a trading venue at the lowest price rather than on a venue that offers the quickest execution or the most reliability.

SARBANES-OXLEY ACT OF 2002

- As a result of SOX, top management must now individually certify the accuracy of financial information. In addition, penalties for fraudulent financial activity are much more severe.
- SOX increased the independence of the outside auditors who review the accuracy of corporate financial statements, and increased the oversight role of boards of directors.
- The bill was enacted as a reaction to a number of major corporate and accounting scandals including those affecting Enron, Tyco International, Adelphia, Peregrine Systems, and WorldCom.
- Opponents claim it has reduced America's international competitive edge against foreign financial service providers.
- Proponents say that SOX has been a "godsend" for improving the confidence of fund managers and other investors with regard to the veracity of corporate financial statements.

GLOBAL RESEARCH SETTLEMENT

- The Global Settlement was an enforcement agreement reached on April 28, 2003 between the SEC, NASD, NYSE, and ten of the United States's largest investment firms to address issues of conflict of interest within their businesses.
- The central issue at hand that had been previously decided in court was the conflict of interest between the investment banking and analysis departments of ten of the largest investment firms in the United States.
- As part of the settlement decision published on December 20, 2002, several regulations designed to prevent abuse stemming from pressure by investment bankers on analysts to provide "favorable" appraisals were instantiated.
- Other than these regulatory actions, the firms involved in the settlement were also to pay fines to their investors, to fund investor education, and to pay for independent third-party market research.

MODULE 2

CORPORATE FINANCE AND CORPORATE STRUCTURES

CORPORATE BONDS

- The term corporate bond is typically applied to longer-term debt instruments with a maturity date falling at least a year after the issue date.
- Corporate bonds are often listed on major exchanges (and referred to as listed bonds) and ECNs, and the coupon (i.e., the interest payment) is usually taxable.
- Corporate debt falls into several broad categories: secured debt and unsecured debt; senior debt and subordinated debt.

CONVERTIBLE SECURITIES

- A convertible bond is a type of bond that the holder can convert into shares of common stock in the issuing company or cash of equal value, at an agreed-upon price.
- Convertible preferred stocks are securities that contain a provision in which the holder may convert the preferred into the common stock of the company under certain conditions.
- Convertible arbitrage involves the simultaneous purchase of convertible securities and the short sale of the same issuer's common stock.
- Forced conversion usually occurs when the price of the stock is higher than the amount it would be if the bond were redeemed.

OPTIONS

- An option that conveys the right to buy something at a specific price is called a call; an option that conveys the right to sell something at a specific price is called a put.
- Today, many options are created in a standardized form and traded through clearinghouses on regulated options exchanges, while other over-the-counter options are written as bilateral, customized contracts between a single buyer and seller.
- The most common options are European, which may only be exercised on expiration, and American, may be exercised on any trading day on or before expiration.
- Nearly all stock and equity options are American options, while indexes are generally represented by European options.

WARRANTS

- A warrant's "premium" represents how much extra you have to pay for your shares when buying them through the warrant as compared to buying them the regular way.
- Warrants are issued by private parties, typically the corporation on which a warrant is based, rather than a public options exchange.
- A warrant's lifetime is measured in years (as long as 15 years), while options are typically measured in months.
- The market value of a warrant can be divided into two components: intrinsic value and time value.
- Warrants are often used as deal sweeteners, in order to entice hesitant investors.

DERIVATIVES

- Derivatives are broadly categorized by the relationship between the underlying asset and the derivative, the type of underlying asset, the market in which they trade, and their pay-off profile.
- The most common types of derivatives are forwards, futures, options, and swaps. The most common underlying assets include commodities, stocks, bonds, interest rates, and currencies.
- Derivatives allow investors to earn large returns from small movements in the underlying asset's price.

- Conversely, investors could lose large amounts if the price of the underlying moves against them significantly.
- Derivatives contracts can be either over-the-counter or exchange-traded.

MANAGING RISK WITH DERIVATIVES

- Companies that produce or depend on the purchase of commodities are exposed to price fluctuations that occur in commodities markets.
- Hedging also occurs when an individual or institution buys an asset (such as a commodity, a bond that has coupon payments, a stock that pays dividends, etc.) and sells it using a futures contract.
- Although a third party, called a "clearing house," insures a futures contract; not all derivatives are insured against counter-party risk.

PRINCIPAL'S CONTRACT LIABILITY

- The principal is liable on an agent's contract only if the agent was authorized by the principal to make the contract. Such authority is express, implied, or apparent.
- Express means made in words, orally or in writing
- Implied means the agent has authority to perform acts incidental to or reasonably necessary to carrying out the transaction for which she has express authority.
- Apparent authority arises where the principal gives the third party reason to believe that the agent had authority. The reasonableness of the third party's belief is based on all the circumstances—all the facts. Even if the agent has no authority, the principal may, after the fact, ratify the contract made by the agent.

PRINCIPLE'S TORT LIABILITY

- The principal will be liable for the employee's torts in two circumstances: first, if the principal was directly responsible, as in hiring a person the principal knew or should have known was incompetent or dangerous; second, if the employee committed the tort in the scope of business for the principal. This is the master-servant doctrine or respondeat superior.
- Respondeat superior imposes vicarious liability on the employer: the master (employer) will be liable if the employee was in the zone of activity creating a risk for the employer ("zone of risk" test), that is—generally—if the employee was where he was supposed to be, when he was supposed to be there, and the incident arose out of the employee's interest (however perverted) in promoting the employer's business.
- Special cases of vicarious liability arise in several circumstances.
- For example, the owner of an automobile may be liable for torts committed by one who borrows it, or if it is—even if indirectly—used for family purposes.
- Parents are, by statute in many states, liable for their children's torts.
- Similarly by statute, the sellers and employers of sellers of alcohol or adulterated or short-weight foodstuffs may be liable.

PRINCIPLE'S CRIMINAL LIABILITY

- The employer of one who commits a crime is not usually liable unless the employer put the employee up to the crime or knew that a crime was being committed.
- But some prophylactic statutes impose liability on the employer for the employee's crime—even if the employee had no intention to commit it—as a means to force the employer to prevent such actions.

AGENT'S TORT LIABILITY

- A person is always liable for her own torts, so an agent who commits a tort is liable; if the tort was in the scope of employment the principal is liable too.
- Unless the principal put the agent up to committing the tort, the agent will have to reimburse the principal.

AGENT'S CONTRACT LIABILITY

- An agent is not generally liable for contracts made; the principal is liable.
- The agent will be liable if he is undisclosed or partially disclosed, if the agent lacks authority or exceeds it, or, of course, if the agent entered into the contract in a personal capacity.

TERMINATIONS OF AGENCY

- Agencies terminate expressly or impliedly or by operation of law.
- An agency terminates expressly by the terms of the agreement or mutual consent, or by the principal's revocation or the agent's renunciation.
- An agency terminates impliedly by any number of circumstances in which it is reasonable to assume one or both of the parties would not want the relationship to continue.
- An agency will terminate by operation of law when one or the other party dies or becomes incompetent, or if the object of the agency becomes illegal.
- However, an agent may have apparent lingering authority, so the principal, upon termination of the agency, should notify those who might deal with the agent that the relationship is severed.