1925

Shares Without Par Value

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Recommended Citation
Clay, Cassius M. (1925) "Shares Without Par Value," Kentucky Law Journal: Vol. 13 : Iss. 4 , Article 3. Available at: https://uknowledge.uky.edu/klj/vol13/iss4/3

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SHARES WITHOUT PAR VALUE

A person who buys a share of stock in a corporation buys primarily a right to share pro rata in the profits and losses of the business. The par value appearing on the stock certificate, tells merely the amount paid in to the corporation by the subscriber. The par value accordingly may more aptly be spoken of as the nominal value, as the actual or market value of the share depends upon numerous factors which have little or no relation to the par or nominal value, viz.: the earnings of the corporation, the dividend rate on the shares, the amount of its surplus and other factors which can only be ascertained by an outsider after some investigation.

These considerations were forcibly and successfully urged upon the New York legislature in 1912 as a reason for the passage of an act permitting the issuance of shares without par value.¹ The removal of the par value was sought as a safeguard to the general public, a sort of "stop, look and listen" sign to place upon the ignorant or the heedless the duty of investigating the actual value of shares of stock before making a purchase.

Since the pioneer act in New York State, similar legislation has been adopted in thirty-four other states.² Shares without par value have met with great popularity in many of these

states, and the legal effect of these acts is a matter of great importance practically to business men and to the legal profession.

Shares without par value have been warmly approved and criticized. The acts in certain states appear to be so loosely drawn as to justify criticism, if they are not positively dangerous. Other statutes, due, no doubt, to the newness of this sort of legislation and in part, perhaps, to a failure by the lawmakers to see fully the significance of the change, contain restrictions that are illogical or affect the workability of the statutes.

Before discussing a suggested amendment of the law, it is the purpose of this article to examine some of the principal arguments in favor of shares without par value, and some of the principal criticisms.


For instance, there is no sound reason, either in theory or in practice, why preferred shares can not be issued without par value, as the preferences as to dividends or shares in distribution, as well as the redemption privileges, if any, can be expressed as easily in terms of dollars and cents as in terms of par value. Yet Delaware prohibits the issuance of preferred shares without par value, apparently on the theory that preferences must be stated in terms of par value. Colorado, and perhaps other states, have similar restrictions.

Various other statutes, including those in Florida and Arizona, contain no provisions for the conversion of existing and outstanding shares with par value into shares without par value, and accordingly raise a doubt whether such a result may be legally accomplished by an exchange for the same or a different number of shares without par value.

The Maine statute may well serve as a model of explicitness on this point: "Any corporation . . . having outstanding shares with par value, may . . . by vote of the holders of two-thirds of its outstanding stock, change such shares or any class thereof into an equal number of shares without par or face value, or provide for the exchange thereof pro rata for an equal or different number of shares without par or face value, provided the preferences, rights, limitations, privileges and restrictions lawfully granted or imposed with respect to the outstanding shares so changed or exchanged, shall not be impaired, diminished or changed without the consent of all the holders thereof, such preferences, rights, limitations, privileges and restrictions, however, to be expressed in dollars or cents per share rather than by reference to par or face value." Maine Rev. Stat., C. 51, Sec. 118.
Because of legal restrictions peculiar to such corporations, shares without par value cannot, under the various no par value statutes, be issued by banks or moneyed corporations.

**Arguments in Favor of Shares Without Par Value.**

Besides the argument most often used, which has already been stated, namely, that the removal of par value will tend to put upon purchasers the duty of investigation and thus safeguard the ignorant or heedless public, there are additional reasons which in particular make shares without par value desirable from the standpoint of the corporation.

Because of constitutional or statutory provisions in most states, shares of par value stock cannot be issued and sold for less than par value. Unless a corporation’s shares of stock are selling in the market for at least par or over, it is accordingly precluded from raising money by the sale of additional stock issues. In order to obtain the new capital that is often necessary for the legitimate expansion and development of the business, the corporation must, in states which do not permit the issuance of shares without par value, borrow it through the issue and sale of notes and bonds. In times of business depression interest charges on notes and bonds may seriously embarrass the corporation. They may become a menace to the entire business enterprise if the corporation defaults, as the holders may then foreclose or, perhaps, throw the company into bankruptcy.

The sale of new preferred stock, which upon casual consideration seems a feasible method of financing, may quite likely be impractical for the same reasons that handicap the sale of new common stock.

This handicap is entirely removed by shares without par value, as such shares may be issued and sold at a price fixed with regard to the marketability of the shares. Under the acts permitting the issuance of shares without par value, the consideration is usually fixed by the stockholders or by the directors acting under general authority from the stockholders. New shares may be issued and sold for a less price than that paid for the outstanding shares.

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*For example, see Del. Gen. Corp. Law, Sec. 4a and N. Y. Stock Corp. Law, Sec. 12.*
In the words of a high authority another factor making for increasing confidence in stock without par value is "the solution it affords to the problem of proper capitalization of corporations commencing business with assets upon which it is difficult to place a present money value, as well as to that of the proper recognition of different values of stocks of corporations upon merger or reorganization."6

CRITICISMS OF SHARES WITHOUT PAR VALUE.

It has been said that the removal of par value is a change of form rather than of substance. After a consideration of the criticisms of shares without par value one questions the accuracy of this statement.

A characteristic feature of the corporation, which serves to distinguish it from the partnership, is the limited liability of its members. A shareholder, except in cases where a different liability is imposed by statute, as in the case of moneyed corporations, is liable to the extent of his stock and no more. The rights of creditors are protected by requirements that stock be paid in to the full par value thereof in money, property or services. If the corporation fails to meet its obligations, the shareholders are liable to the creditors of the corporation to the extent of their unpaid stock.

Although this protection has without doubt been whittled away in many cases, due to statutory and procedural difficulties, and, particularly where stock has been issued for property or services upon which a present money value cannot readily be fixed, to the difficulty of proving that the directors made a dishonest or inadequate valuation, in the case of stock with par value the personal liability of the shareholders is measured, in theory at least, by the par value of the outstanding shares.7 A person taking the obligation of a corporation with outstanding capital stock of $100,000.00 par value may theoretically assume that either $100,000.00 in money, property or services has been paid in to the corporation, or that the shareholders are personally liable for the deficiency. There is no need for him to in-

7 For a discussion of the nature and extent of this liability see Corpus Juris, Corporations, Secs. 1474-1796, Inc.
investigate how much has been paid in and how much has not, if the shareholders are persons of financial responsibility.

In different circumstances he has a second protection, which operates in favor of the shareholders as well. If the directors declare dividends out of the $100,000.00, the directors are personally liable for the amount of the illegal dividends.

What happens to these two safeguards when a corporation issues shares without par value? Critics have said they have been either seriously impaired or removed.

Before examining such claims, we will note another criticism, which appears of less merit.

This criticism is that shares without par value open the way for fraud upon the existing shareholders by making possible the issue of new shares for an insufficient consideration. While it is true that new shareholders who become such by paying in a less amount for their shares, are on an equal footing with the holders of the outstanding shares, and entitled to the same dividends and the same aliquot shares in distribution, there can be strictly speaking no fraud upon the existing shareholders when the issue of new shares for a less consideration is authorized by law. A purchaser of a share of stock without par value purchases with knowledge that at some time in the future another may purchase a like interest in the corporation by paying a less price to the corporation. One who purchases in the market a share of stock with par value, purchases with the same risk, with a single distinction. Additional stock without par value may originally be issued for a less consideration than that paid for the outstanding shares, while stock with par value cannot be originally issued for a consideration less than the par value. In the first instance the actual or market value of the shareholder's interest, his aliquot share in the corporation may be depreciated by the additional issue, if the consideration therefor is below the actual or market value. In the second instance the actual or market value will be depreciated if the par value (the consideration received for the additional issue) is less than the actual or market value. This is clear by a simple illustration. Suppose a corporation has assets in excess of its obligations worth $100,000.00 and 1,000 shares of stock without par value outstanding. The actual or market value of the outstanding shares let us then assume will be $100.00 per share. If the cor-
poration issues an additional 1,000 shares without par value for $100.00 per share, the actual or market value of the outstanding shares will not be depreciated. If, however, it issues the additional 1,000 shares at a price of $50.00 per share, the actual or market value of the outstanding shares will be depreciated from $100.00 to $75.00 per share, as it will have outstanding 2,000 shares of stock against assets worth $150,000.00. Taking the second instance, if the corporation originally had 1,000 shares of outstanding stock with a par value of $100.00 per share, the actual or market value of the outstanding shares is not depreciated by the additional issue of 1,000 shares for $100.00 per share. But if at the time of the additional issue the corporation’s assets were worth $200,000.00 and consequently the actual or market value of the outstanding shares was $200.00 per share, such actual or market value will be depreciated if the corporation sells 1,000 additional par value shares at $100.00 per share from $200.00 to $150.00 per share, as the corporation will then have outstanding capital stock of $200,000.00 against assets worth $300,000.00.8

We thus have a distinction without a great difference. While there may be greater room for abuse of the rights of the existing shareholders under the no par value acts, as we shall see hereafter, their rights in either instance receive adequate protection only by the preservation of the preemptive rights to subscribe pro rata for additional shares issued from time to time.9

The criticisms that shares without par value impair or remove the safeguards arising from the personal liability of stockholders for unpaid subscriptions and from the liability of directors for illegal dividends are more serious.

As a recent critic has discerningly pointed out the no par value acts of Delaware and New York are particularly subject to criticism on these grounds.10

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8For the sake of clearness, and as, generally speaking, actual or market value varies with book value, we have used in the above illustration “actual or market value” for what is obviously “book value.”

9Situations may easily be imagined in which an additional protection will be afforded by the courts upon equitable principles, by an injunction preventing the new issue, or perhaps in certain instances, as suggested by Berle in Col. L. Rev., Vol. XXIV, pp. 62 and 63, by a decree of cancellation.

10Bonbright in Col. L. Rev., Vol. XXIV at 459 and following.
These states are important not only because of the large number of corporations which are constantly being formed in them, but because their no par value acts have served as a model in a large number of other states.

The Delaware Law.

The act permitting the issuance of shares without par value reads in part as follows:

“Such stock may be issued by the corporation from time to time for such consideration as may be fixed from time to time by the board of directors thereof, pursuant to authority conferred in the certificate of incorporation, or if such certificate shall not so provide, then by consent of the holders of two-thirds of each class of stock then outstanding and entitled to vote given at a meeting called for that purpose in such manner as shall be prescribed by the by-laws, and any and all shares so issued, the full consideration for which has been paid or delivered, shall be deemed full-paid stock and not liable to any further call or assessment thereon and the holder of such shares shall not be liable for any further payments under the provisions of this chapter.”

The critic above mentioned points out that, where shares are issued for cash, this provision seems to be entirely adequate to protect creditors. He continues:

“For in such case the prospective creditor of a corporation may rely on the amount of cash capital which stockholders have subscribed with just as much confidence as he might have relied on the implied obligation of the shareholders to pay the full par value of the shares. But where the stock is issued for property, a different situation prevails. Under the old system, when a promoter receives stock in exchange for property, he can be held by creditors for any difference between the value of the property and the par value of the stock. Under the Delaware law providing for no-par stock there seems to be no liability on the part of the promoter-shareholder provided that he delivers to the corporation the precise pieces of property that he contracts to deliver. As to the value of this property he need say nothing. He may even receive two thousand shares of stock for a yellow dog and a dead cat without being subject to further assessment; for he has made no claim as to the value of these two animals. It is therefore difficult to escape the conclusion that the Delaware law in effect though not in form, has cut off the creditors’ remedy of shareholders’ liability where stock is issued for property or services.”

Nor does he find the situation any more satisfactory under this law with respect to the second safeguard in favor of creditors and stockholders, viz.: that the directors shall be liable for illegal dividends declared out of capital. The only limitation in the Delaware law on corporations with no par value stock is that they shall not commence business with less than

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23 Ibid, 461, 462.
ten shares.\textsuperscript{14} Pointing out that the law does not define what shall constitute capital, he says:

"It would seem, then, that under the Delaware law a company issuing shares without par value is entirely free to credit to capital account as large or as small a part of its assets as it sees fit. If this is so, a company may issue stock for fifty dollars a share and simply by crediting all but five dollars to surplus other than capital may leave itself free to pay back to its stockholders forty-five dollars a share. Such a possibility is a serious danger as it opens the way for stockholders to milk the company of its property and thus to defraud creditors."

**The New York Law.**

As the original New York statute permitting the issue of shares without par value has several times been changed by amendment and re-enactment,\textsuperscript{15} we should expect the present law to be more perfect than the Delaware law. In New York, the certificate of incorporation must contain either one of the following statements with respect to the capital with which a corporation with no par value shares carries on business:

"A. The capital of the corporation shall be at least equal to the sum of the aggregate par value of all issued shares having par value plus.................dollars (the blank space being filled in with some number representing one dollar or more) in respect to every issued share without par value, plus such amounts as, from time to time, by resolution of the board of directors, may be transferred thereto; or

"B. The capital of the corporation shall be at least equal to the sum of the aggregate par value of all issued shares having par value, plus the aggregate amount of consideration received by the corporation for the issuance of shares without par value, plus such amounts as, from time to time, by resolution of the board of directors, may be transferred thereto.

"There may also be included in such certificate an additional statement that the capital shall not be less than.................dollars (the blank space being filled in with a number)."\textsuperscript{16}

A further provision permits the issue of shares:

"(a) For such consideration as may be prescribed in such certificate of incorporation; or (b) for such consideration as shall be the fair market value of such shares, and, in the absence of fraud in the transaction, the judgment of the board of directors as to such value shall be conclusive; or (c) in the absence of fraud in the transaction for such consideration as, from time to time, may be fixed by the board of directors pursuant to authority conferred in such certificate of incorporation; or (d) for such consideration as shall be consented

\textsuperscript{14} Del. Gen. Corp. Law, Sec. 5, par. 4.
\textsuperscript{16} N. Y. Stock Corp. Law, Sec. 12.
to or approved by the holders of a majority of shares entitled to vote at a meeting called in the manner prescribed by the by-laws, provided the call of such meeting shall contain notice of such purpose. Any and all shares issued as permitted by this action shall be deemed fully paid and non-assessable and the holder of such shares shall not be liable to the corporation or its creditors in respect thereto."

The same critic\(^{17}\) shrewdly observes that (1) although this law permits a corporation to fix its capital at the "aggregate amount of consideration received by the corporation for the issuance of shares without par value" it does not expressly require that the "consideration" for which stock is to be issued, be stated by the subscriber in terms of value, and that consequently, unless the courts establish judicially that the consideration must be so stated by the subscriber, it may be stated by him merely by a description of property, thus opening the way for the same evasion of stockholders' liability that is present under the Delaware law and (2) while under the New York laws a corporation may not impair its stated capital, it may, under alternative "A," as likewise seems possible under the Delaware law, make this capital just as small as it desires, simply by crediting a large part of the proceeds of its stock issues to paid-in surplus rather than to the capital account.

**Force of First Criticism of Delaware and New York Laws.**

Both Delaware and New York purport to prohibit fictitious stock issues by constitutional or statutory restrictions that stock may be issued only for money paid, labor done or property actually acquired.\(^{18}\) Consequently stock can only be legally issued for a valuable consideration. While these provisions would probably prevent the legal issue of stock for a "yellow dog" or a "dead cat" they offer a doubtful protection against the issue of no par value stock for good-will or patent rights of uncertain value. Such consideration may nearly always be found to have some value, even if small or speculative.

As even a small or speculative consideration is sufficient under the Delaware law, and perhaps also under the New York law, to make the stock full-paid, the force of the first criticism that it is easier for shareholders to escape personal liability to creditors with no par value shares than with par value shares

\(^{17}\) Bonbright, Col. L. Rev., Vol. XXIV, 458, 464.
\(^{18}\) Del. Const., Art. IX, Sec. 3, and N. Y. Stock Corp. Law, Sec. 69. (See also Ky. Const., Sec. 193; Ky. Stat. 563—Editor.)
cannot be denied. A simple illustration is convincing. Suppose the good-will and patent rights received in consideration for the issuance of 1,000 shares of stock are found by the court to have been actually worth $1,000.00. If the 1,000 shares had a par value of $100.00 per share, or an aggregate par value of $100,000.00, the stockholders in the event of the failure of the company, would then be subject to a maximum personal liability of $99,000.00. But if the 1,000 shares were shares without par value they would be subject to no personal liability.

This illustration again serves to show the significance of par value, as distinguished from actual or market value. Assuming that the corporation had no other assets but the good-will and patent rights received for its 1,000 shares of stock, the actual or market value of the shares should be the same regardless of whether the shares had a par value of $100.00 per share or were without par value. In either instance, the enterprise to which creditors extend their credit is the same. From the standpoint of public policy the 1,000 shares of no par value stock come closer to the truth than the 1,000 shares of the par value of $100.00 each.

The interests of creditors are not prejudiced in the second instance if a money value is set upon the no par value shares by the subscriber, and the amount of this money value is made accessible to any one who cares to investigate the same. Taking our illustration above it cannot be said that creditors’ rights are prejudiced through the issuance of 1,000 shares of no par value stock, if they become creditors of the corporation knowing that the subscribers and directors have fixed $1,000.00, only as the money value of the corporation’s assets.

Such an amendment should be made in the states which have the Delaware and New York types of statute.

EXAMINATION OF SECOND CRITICISM.

The criticism that under the New York law, and presumably also under the Delaware law, a corporation may issue shares without par value, say for $50.00 per share, and by crediting to surplus all but $5.00 per share reserved as "capital," pay out the $45.00 in dividends to stockholders, if sound, as it appears to be, exposes a serious defect but one capable likewise of being remedied by amendment.
There is no legal objection to a corporation having shares of par value stock selling its shares at a premium above par and by crediting the premium to surplus, making it available for use in dividends. The practice of crediting a part of the consideration received for the issue of shares is accordingly one that may be indulged in under laws permitting only the issue of par value stock, and is therefore not intrinsically a legal innovation. As a practical business matter par value stock can not be marketed at a premium unless the actual or market value of the outstanding shares is higher than the par value plus the premium, but this does not weaken the analogy.

Since therefore the practice is one not new to our laws, it would seem that all objection from the viewpoint of creditors and shareholders would be removed, if a corporation issuing shares without par value were required to credit to capital the cash value of the consideration received from subscribers, unless otherwise agreed to by the subscribers, and in every case to file publicly for inspection by interested parties a statement showing what part of the consideration received was to be considered as capital and what part was to be considered as surplus, liable to distribution in dividends.

Inadequacy of Present No Par Value Laws to Accomplish Purpose Originally Urged.

As already seen shares without par value were originally advocated as a sort of "stop, look and listen" sign to put upon the unwary the duty of investigation. The reform permitting the issue of such shares fails to accomplish its original purpose unless the law provides means by which those who have the duty of investigation may investigate.

In Illinois there is a requirement that the consideration received for shares of capital stock be stamped on the stock certificate. Under the laws of Virginia a corporation is required to report to the Corporation Commission the nature of the consideration received, though the same is required with respect to shares of par value stock. Recent statutes in Louisiana and Arkansas will be noticed later. In the vast majority of states, however, the papers which the corporation is required to file

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20 Code of Va., Ann. (1919), Sec. 3788.
officially with the state contain no clue as to what the corporation is to receive or has received for its shares.

Unless the law requires the nature of the consideration received by the corporation for its no par value shares to be made public a prospective purchaser, whose duty it is to investigate, has no means of knowing whether such shares have been issued for $1,000.00 or $1.00 per share, without access to the corporation’s records. Access to the minute books, which contain the authorization by the directors, is ordinarily denied, or if permitted by favor of the corporation’s officers, seldom practicable, if the party desiring the information resides in a state other than the state in which the corporation is domiciled. The corporation’s balance sheet, if one be issued, will it is true show how much capital and how much surplus there is, but it will not show for how much outstanding shares have been issued or what was the nature of the consideration.

Under the present no par value laws, with a few exceptions, it follows that persons unfamiliar with the organization of the corporation, without the cooperation of its officers, have no means of finding out for what shares have from time to time been issued, or what is the personal liability of the shareholders.

**Suggested Amendment of the Law.**

It is suggested that a corporation issuing shares without par value should be required to file after or contemporaneously with each issue of such shares, in the State office or offices in which its charter is recorded, where it can be inspected at any time by interested parties, a certificate under oath showing:

1. The number of shares without par value issued, together with the number previously issued.
2. Whether the additional shares were issued for cash, property or services.
3. If issued for cash, the amount of cash per share.
   (a) How much of this is to be credited to capital.
   (b) How much to surplus.
4. If issued for property or services, the character and nature thereof.
   (a) The cash value placed thereon in the agreement of subscription.
   (b) The cash value fixed by the directors on the books of the corporation.
   (c) How much of this value is to be credited to capital.
   (d) How much to surplus.\(^2\)

\(^2\)See Acts, La. (1924), No. 96, approved July, 1924 (particularly Secs. 4 and 5). This statute, which requires a corporation issuing shares without par value to file with the Secretary of State, within 90
If the new issue of shares is merely an exchange of a greater or lesser number of shares for the shares previously outstanding without the addition of anything to capital account, as for instance where a corporation with 1,000 shares without par value, divides its shares into 100,000 shares without par value, or conversely exchanges its outstanding 1,000 shares for 100 shares, the certificate in place of the statements mentioned above, should state merely the basis of the exchange.

The large number of states which have passed laws permitting the issuance of shares without par value, testify that in the states where such shares have been tried, the removal of the par value is generally considered by lawyers as a desirable improvement in corporate law.

It is submitted that an amendment of the nature suggested will meet in some measure the objections which have been raised by the critics and which are undeniably meritorious.22

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22 Various cases have raised numerous questions with respect to the taxation of shares without par value. A discussion of some of these decisions is reserved for a possible later article.

N. B.—Since the above was written, the Delaware law has been amended so as to permit the issuance of preferred shares without par value. Acts of Del. Legis., April 2, 1925, sec. 3.