THE PAR VALUE OF STOCK.

It is quite apparent that there are some features of our corporate system which require re-adjustment, if not abandonment. Indeed anything which achieves so widespread and frantic a popularity among all sorts and conditions of men is apt to arouse a suspicion that it possesses more than a legitimate attractiveness. And the truth of the matter seemes to be that corporations, like all other human institutions representing a growth, have had a tendency to preserve in crystalized form, elements which have lost their usefulness or are even positively harmful.

A great deal of remedial legislation has been suggested and some has been adopted. There are, however, at least two points of attack and it seems as though the efforts had been directed principally towards the less easily controllable. In other words, it is possible to change some of the present characteristics so that when a corporation comes into existence it will necessarily act in a manner different from that which is now possible for it. On the other hand, all the present features may be retained and laws adopted imposing penalties for any improper use of such powers. The majority of writers and legislators appear to direct their attention to this second branch and by suggesting penalties as, for example, the imposition of a personal liability upon directors or stockholders, to confine corporate operations within proper bounds.

But although repressive measures may in some cases be the only practical remedy, it is better to clip a bird's wings than to resolve to punish it if it attempts to fly too much. And if it appear that a certain feature is not essential to the corporate mechanism or has been outgrown and restrictive statutes are not able to prevent its abuse, it would certainly be more simple and efficacious to abolish it altogether with only a transient inconvenience.

Fiat money, the threat of which occasionally looms above the financial horizon and fills conservative men with anxiety, is widely discussed and widely denounced. Political economists unite in earnest assertions that nothing but evil can result from such attempts to create value by stamping paper with a symbol endorsed by the Government. It is a little curious, therefore, that

an analogous feature of corporate organization seems to be taken for granted as a necessary incident, and one scarcely hears a suggestion that it be discontinued. This is the practice of requiring a "par" or face valuation for every share of stock.

Our Stock Corporation Laws provide that the certificate of incorporation shall set forth the arbitrary figure which of course is derived from the total amount of the "capitalization," divided by the number of shares. That capitalization itself has lost all dignity and significance, so far as ordinary mercantile corporations are concerned, is evident enough, if only from the paltry considerations by which its amount is determined. Thus Mr. Dill in commenting on the General Corporation Law of New Jersey, naively observes:[1] "In view of the fact that the cost of filing the certificate of incorporation is the same (i. e. $25.00) for any amount of total authorized capital not exceeding $125,000.00, it is customary to insert in the certificate power to issue stock to the amount of $100,000.00 or $125,000.00." A trifling organization tax, in other words, now settles the amount which was originally intended to represent so much money paid in to the treasury of the company.

Of course, if, as is the case with "monied" corporations, the entire capital had to be paid by the stock subscribers in cash, and thereafter maintained intact as a permanent and undiminished fund above all debts, there would be some justification for establishing a par value. But as stock may now be issued for money, labor performed, or property, and, in the absence of fraud, no question may be raised as to the actual value of the labor or property by which the payment is made, the gateway has been opened for the most astounding inflation. It is notorious that shares are now delivered in return for a variety of intangible rights at preposterous valuations and then with the unctious phrase "full paid and non-assessable" attached, re-issued to the public for whatever price they may be induced to pay. The par value, consequently, has become little more than an attempt to create the semblance of value by the activity of the printing press. From the moment of their issue to the time of the dissolution of the corporation, the shares never see the value that is bestowed upon them and set forth blandly in the certificates except through some very unusual circumstance.

That it has become the merest fiction is also evident from the fact that courts have disregarded it when recognition would have

1. Dill on Corporations, 4th ed., p. 22.

been inequitable. Thus in an instructive Pennsylvania case,[2] a company was "capitalized" at $1,000,000 and stock certificates for this amount "at par" were outstanding, but only five dollars had been paid upon each fifty dollar share, or $100,000 altogether. The charter provided that the company could not issue bonds in excess of fifty per cent " of the par value of the stock." Suit was brought to enjoin an issue of $250,000 of bonds and an injunction was granted The court declined to recognize the fifty dollar "par value" established by the charter, and held that as only five dollars a share had been received by the company, that was the real par value and the other merely "nominal." Among other things it was said: "It is argued that nominal value and par value are synonymous terms in the commercial vocabulary, and that the par value of the stock of this company is one million dollars, because that is the amount of its nominal or authorized capital. If this is so, the par value has not been affected by the payment of the calls upon the subscriptions herotofore and will not be hereafter. Whether the amount paid is ten per cent or fifty, or one hundred per cent of the authorized capital, the par value must, according to this doctrine, remain the same. This overlooks the meaning of the word value, and the basis on which the idea of value rests. The par value of a treasury note or bank bill is the sum named on its face, because the holder can demand and is entitled to receive that sum for it (from the issuer). When it cannot be so exchanged it is said to be below par. But a certificate of stock is not a negotiable instrument. It stands in the hands of the subscriber for an amount equal to and no more than the amount actually paid upon it.

"How then is the equivalent, the par, in value of the stock in the hands of the holder to be ascertained at any given time? Very clearly by the books of the company, which show for what value it stands, what value it represents at that time." Some of these remarks seem a little peculiar perhaps, although the conclusion was the only reasonable one at which to arrive. It was reached, however, by brushing aside what certainly was the par value as generally understood and adopting an arbitrary one based upon the amount actually paid into the company.

This was the court's answer to an attempt by a corporation to make an empty phrase the substantial basis for undertaking a very substantial liability and so defeating the object of an entirely reasonable statute. But courts have also disregarded it when

2. *Commonwealth v. Lehigh Ave. Ry. Co.*, 129 Pa. St. 405.

adherence to it might have embarrassed the corporation itself. This appears in a modification of the rule formerly held by many state courts and declared by the Supreme Court of the United States,[3] that the shares of a corporation could not be originally sold and distributed for less than their par value either in money or property.[4] Thus in *Handley v. Stutz*[5] a coal company "capitalized" at $200,000 and with $120,000 of the stock outstanding became obliged to raise $50,000 in order to continue business. The issued shares were of course greatly depreciated and, naturally, no one could be found to give "full" value for the unissued. Finally bonds to the amount of the required sum, although not marketable by themselves at their principal value, were sold by giving an equal amount of the previously unissued stock as a bonus. The $30,000 of stock still remaining was then distributed among the old stockholders as a present. In a creditor's bill to compel payment to the corporation of the par value of the new stock in cash, the court declared that under such circumstances the old stockholders who had received the new shares without any consideration whatever would be liable for "the value." But as to the stock delivered with the bonds it was held that "an active corporation may, for the purpose of paying its debts and obtaining money for the successful prosecution of its business, issue the stock and dispose of it for the best price that can be obtained."[6]

To repeat, in the Pennsylvania case the court refused to allow the corporation to take advantage of an absurdity when it would work injustice to others. In the Federal case, the decision was that the corporation would not be held to this fiction when the course would embarass the company itself. The cases thus supplement one another.

One hesitates in this era of unrestrained language, to express unduly harsh judgments, but it seems as though the chief attraction of the habit of creating apparently definite values were the unusual opportunities it affords to mislead. Like "collateral trust bonds" which induce stockholders to part with voting privileges and the benefit of possibly increased dividends in exchange for a fancied greater security, or second mortgages masquerad-

3. *Upton v. Tribilcock*, 91 U. S. 45.
4. Thompson, Comment on Corporations, Preface VII.
5. 139 U. S. 417.
6. In *Rickerson, etc., Co. v. Farrell, etc., Co.* (75 Fed. Rep. 554), this doctrine was limited to the payment of existing debts, having no application when the object was merely to extend the business. Of course this means simply that the Court dislikes to disregard tradition unless there is a necessity for so doing. There is certainly no logic in the distinction.

ing as "consolidated" or "general" liens, the suggestion of more worth than exists in reality is made. "The least intelligent investor" observed a well-informed writer, "may be greatly deceived by the mere nominal figure of capitalization itself. To him a million dollars of stock must somehow represent a million dollars of value. Figures of cost and earnings he has not scrutinized closely. Indeed all investors are influenced to some extent by this superficial figure."[7]

When a corporation is reorganized, tables are published in which the par value of the new stock and the principal value of the new bonds to be issued in the exchange for each unit of old securities are added together, to make as brilliant an appearance as possible and induce the holders to "come in." Thus they sometimes seem to be getting much more than they had before. And it is certainly not unusual for one company owing stock of another, to carry the securities at the face value of the certificates upon its books and so exhibit a prodigious total of assets, although they might be almost, if not quite, unmarketable. "Watered stock" under present circumstances, does not seem from a superficial view to be so much a mere lessening in value of all the other shares, as an expansion of the corporation. A "ten million dollar" company is much more imposing than one with one hundred thousand dollars of capital, however shrunken the assets of the one may be or however great those of the smaller.

A proposal for the discontinuance of this deceptive and unnecessary practice was made in a recent illuminating address before the New Hampshire Bar Association.[8] "I would not" the speaker is reported to have said, "have the law require for the shares any money denomination, that is to say, any par value. Why should the par value of each share be prescribed? What purpose do these statements in the instrument of incorporation serve? Do they not lead very commonly to fictitious capitalization, to statements by corporations and by those who promote them that are misleading, to an unreasonable and sometimes an oppressive or even dangerous effort in the result to justify a capitalization which originally was unjustified? Do they not oftentimes lead to absurd and even immoral discrepancies, between the nominal money valuations made for purposes of public taxation? If our system of corporate capitaliza-

7. E. D. Durand "Stocks Watering," *Independent,* Sept. 18, 1902.

8. Mr. E. M. Shepard of the New York Bar. See *N. Y. Evening Post,* Tuesday, October 2, 1906.

tion produces as I think it does, these and other evils, is it nevertheless necessary? Does it serve any purpose except to facilitate operations of promoters and of bankers which serve no good purpose to the community?"

This seems to be eminently sound. But why should we not go a step further and prohibit corporations from giving any apparent value to their shares instead of merely permitting them to refrain from so doing? Let every company, for instance, set forth in its charter, instead of the arbitrary "capitalization," a statement of all property it has received or will receive and the number of shares it is proposed to issue. Each one would then represent, without any obscurity, a proportionate interest only in the net assets of the corporation.

It is always difficult to prophesy with accuracy what practical effect will be produced by new methods. But it seems reasonable to suppose that the change suggested, apart from conforming to the simple truth and preventing much misconception, would have some positive and beneficial results. Thus it would at least tend to lessen the absenteeism that is so conspicuous now in corporate management. What does the average stockholder know about his company? So long as he seems to have a definite financial interest, he is content with the knowledge that it is "doing well," that certain able men are guiding its operations and that dividends are received regularly. If it were brought home to him that his interest was an indeterminate one, obviously dependent upon the varying fortunes of the corporation, he would be far more apt to follow its operations in detail and request periodical statements. And this would probably result in a publicity that is not vouchsafed, but which is certainly one of the most legitimate of present day demands

The only real objections to the proposal are of detail, so far as is apparent. It would be quite as easy to pay dividends at so many dollars a share as upon a percentage basis. And if it seem necessary or desirable to continue the division into classes of preferred and common stock, the preference of the former in the distribution of assets could be placed at any reasonable figure.

Radical changes, of course, should be brought about slowly, and only after prolonged discussion, so that any disturbance or confusion would be reduced as much as possible. It seems unfortunate, however, that the invaluable corporate mechanism should be permitted to accumulate and preserve barnacles that engender suspicion without serving a useful purpose. At least one may hope that this subject will receive greater attention in the future than has been accorded it in the past.

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