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No-Par Stock -- Its Nature and Use

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A sense of great elation must have electrified the legal profession, or that portion which had close contacts with financial interests, when in 1912 the issuance of no-par stock was made legal by the New York legislature. Nor were these smiles of gratification confined entirely to those who directed the legal steps of financial buccaneers. The honest and the righteous also had reason, they believed, to welcome this departure from the old rigidities contained in the par-value concepts then prevalent.

Whatever else may have been accomplished by that departure, it most assuredly started a new legislative fashion. Apparently all but one of the states have adopted that fashion, though often with important deviations. All this being true, it is not without interest to note that a growing reluctance has appeared in the corporate world with respect to the use of no-par stock. The issuance of such stock, indeed, has tended of late to wither on the vine.

On the one side, the great expectations of the buccaneers have begun to grow dim. On the other, tax laws have imposed highly discriminating tax burdens on the use of no-par stock. Business is thus not following the legal fashion, and if there really are potential advantages in the use of no-par stock they will not become generally effective in practice until its handicaps are removed and its real nature is more widely understood.

To proceed into the hotly disputed central court of finance, where the real nature of no-par stock can be found and compared with par-value stock, is not easy without a guide; and even an experienced guide cannot be sure of putting his feet down every time on solid ground. To gain any entry at all, the most promising approach would seem to be along the shell-pocked highway over which proponents and opponents battled so bitterly in the early part of the century. From the marks left in that bitter struggle can be read quite clearly an exciting chapter in which the expectations of the buccaneers were forthbiitingly, if not always convincingly, by those who considered no-par stock legislation as a clear victory for the evil forces of Mammon.

Among the strongest opponents of no-par stock were J. C. Bon-

* Member of the bars of New York, Massachusetts and Maine; lecturer at Boston Univ. School of Law on "The Law of Corporation Finance"; author of many law review articles and of two books on economics: MANAGING THE PEOPLE'S MONEY (Yale Univ. Press, 1935) and A CREATIVE CAPITALISM (Boston Univ. Press, 1948).

1. N. Y. Stock Corp. Law § 12.
2. Stand-out: Neb. Const. Art. XII, § 6 (1920), requires a face or par value for all stock, and all shares of a corporation must have the same value.
bright and H. W. Ballantine; Adolph Berle, meanwhile, was conspicuously industrious in chipping away with penetrating logic at many of the illusions then haunting the minds of some, and eagerly embraced by others, of the less keenly analytical legal lights of the day. The major attacks on no-par stock were made some twenty-odd years ago, and since then the legal journals have contained relatively little on the subject, until December, 1947, when "Problems of Par and No-Par Shares: a Re-Appraisal," a carefully written article by Carlos L. Israels, appeared in the *Columbia Law Review.*

Perhaps Bonbright's most striking attack on no-par shares took place in 1924, in his article *Shares Without Par Value.* These points are summarized now because they shed light on interpretations which at the time brought joy to the hearts of many a financial buccaneer, and at the same time moved to rage and tears a number of high-minded teachers of law and allied topics who viewed the no-par stock statutes as a disgraceful defeat for the public interest. Yet, in the author's opinion, neither predatory joy nor high-minded tears was really warranted.

**Original Objections to No-Par Stock**

Under the New York statute, as amended to permit no-par stock, two alternatives were made available to corporations. After providing that the capital of a corporation shall be at least equal to the sum of the aggregate par value of all issued shares having par value, the statute went on to provide that capital might also include a further sum measured as follows: "—— dollars (the blank space to be filled in with some figure, not less than $1) in respect to every issued share without par value"; or, in the alternative, the incorporation papers need not name any stated value for each share, but instead could attach a money value to "the aggregate amount of consideration received by the corporation for the issuance of shares without par value." In either case, the original capital could be augmented, by such additional amounts "as, from time to time, by resolution of the board of directors, may be transferred thereto."

Viewed in the cooler light of the present day, after tempestuous controversies on the matter have faded away, it can be seen that the differences between par value stock and no-par stock, as authorized by New York law, are superficial. In the case of par value stock, capital is represented as equal in money value to the number of shares issued, multiplied by the par value as printed on each certificate. In the case of "no-par" shares, New York style, the certificate itself contains no representation of value, but the money value of capital it represents is none the less clearly set forth in the incorpora-

4. 24 Col. L. Rev. 449 (1924).
5. Supra note 1.
tion papers. Either a definite value is ascribed to each no-par share, or, in the alternative, to all the no-par shares of the issue. Aside from the appearance of the certificate itself, it is indeed difficult to find any material difference between the so-called “no-par” stock and a par value stock of equal unit value.

Many later statutes have shown more intellectual honesty with respect to no-par stock. Apparently recognizing that New York’s law on the subject was little if any more than pretense, Massachusetts and many other states expressly repudiated the requirements as to money valuation for no-par shares either separately or as a whole, though, of course, for accounting purposes some such valuation is essential. Massachusetts permits a corporation to “issue its authorized shares without par value for such cash, property, tangible or intangible, services or expenses as may be determined from time to time by the board of directors . . . and when the cash or other consideration for which they are to be issued . . . has been received, said shares shall be fully paid stock and not liable to any further call or assessment thereon, nor shall the subscriber or holder be liable for any further payments . . .” except in cases where holders of fully-paid par value stock would also be liable.

It was, doubtless, mainly against provisions of the Massachusetts type that Bonbright went gunning with all the heavy artillery at his command. In his Columbia Law Review article, his objections were stated with clarity and vigor. Though not a lawyer, he was at one time in the investment business and thereafter took up the teaching of economics and finance; and his voice was a powerful one in favor of controls over public utilities. Bonbright took the no-par statutes at face value and determined his position accordingly.

No-par stock was objectionable to him on three main counts. He believed it would: (a) strip corporation creditors of an apparently important protection found under par value stock law: the liability imposed on stockholders whose stock was issued for less than par value; (b) permit corporations to segregate parts of the capital received from a stock issue, and by designating it as “paid-in” surplus to make it available wrongfully for the payment of dividends; and (c) allow directors to defraud existing stockholders by selling additional stock of the same kind at an unduly low price, thus diluting the value of previous issues.

Unlike some “viewers with alarm,” Dr. Bonbright had the grace to offer remedies intended to allow the modified use of no-par stock. His proposals were designed to eliminate or mitigate the evils he so vigorously denounced.

Statutes like the Massachusetts provision, it will be recalled, permit no-par stock issuance without definite valuation of the consideration or capital it represents. This to Bonbright seemed like deliberate invitation to faster tempo in the dishonest dance then known as “frenzied finance.” Disregarding

7. Supra note 4.
whatever really honest reasons there might be for such measures, he accordingly concentrated the fire from one battery against those provisions which, to his mind, stripped away from creditors their recourse against stockholders when actual consideration was in fact of materially less worth than the money value ascribed to it by action of the corporate directors. He demanded the valuation of such assets, with responsibility on directors for over-valuation.

A second battery was directed against the allocation, to a “paid-in” surplus account, of any part of the consideration received in payment for no-par stock. All such consideration Bonbright regarded as “capital” for the corporation, and he wanted it protected, to the full extent of the law, from possible payment to the stockholders as dividends, to the detriment of creditors. With all due respect for his good intention, he evidently overlooked such legitimate reservations of “paid-in” surplus as are needed, for example, when the internal reorganization of a prosperous concern takes place through a sale of its assets to a new corporation in return for the latter’s stock.⁸ If the old concern has an earned surplus available for the payment of dividends, why should not the new corporation take those assets without losing that privilege, as it would be lost under Bonbright’s insistent proposal?

Imminently present in Bonbright’s mind, too, was the prospect that directors might defraud existing stockholders by diluting the value of their stock. This, of course, would come about if additional stock of the same kind were issued at a price substantially lower than book value of the old stock at the time. To prevent it he wanted two positive provisions added to the law. First, he proposed that the common law principle of “pre-emptive rights” for stockholders be enacted into law as an inalienable right, except when stock was issued in payment for definitive property. This, of course, would entitle an existing stockholder to buy new stock at its price of issue, in proportion to his prior interest in the company, if he wished, and no charter provision to the contrary would be legally valid. He wanted also to create a statutory right under which stockholders might sue the directors in a fraud action, if later stock issues were sold to outsiders at an unduly low price.

The intervening years have not treated these jeremiads and phillipics of Bonbright with any great kindness, as many well know. In his favor, however, one thing at least can be said without much reservation. In large part, the financial bar of a quarter century ago substantially accepted his views, so far as the meaning of no-par statutes was concerned. Those lawyers with leanings toward the predatory side were in consequence elated with premonitions of opulence and profit, while most lawyers of other inclinations viewed such dangers as offset by the legitimate advantages looked for in the use of no-par stock.

⁸ See Hood Rubber Co. v. Commonwealth, 238 Mass. 369, 131 N. E. 201 (1921).
A Source of Needed Relief

These no-par statutes did assuredly offer positive relief to business men and their lawyers at a number of points where it was badly needed. Under existing decisions, by judges who seemingly felt that the old technical concepts of corporation law must be upheld at whatever cost to the legitimate processes of creative enterprise, a veritable barbed wire entanglement of legal doctrine had grown up around par value stock. The promotion of a corporation had come, accordingly, to take on some of the unwholesome aspects of doing business under a bureaucracy manned by incompetents who know little and care less about the activities they control.

A striking instance, unfortunately not yet relieved by legislative action, is the concept that corporations have no existence prior to their receipt of a charter. While, to be sure, this is sound enough in legalistic logic, the consequence is that prior to the magical charter date no one anywhere has authority to make contracts binding on the embryo corporation, despite the countless decisions that have to be made before even its size and nature can be determined, and its charter needs accurately defined. Physical quarters must be secured; competent officers and key members of the staff must be found; patent rights are often necessary and must be made available; and funds to finance the venture are, of course, utterly indispensable. Yet any preliminary engagements as to these things are in the eyes of the law anomalous if not fictitious. They are "much ado about nothing," and have no force or validity until lawfully adopted or "accepted" by the corporation after its charter is received. Such ratification, to be sure, is usually given; but it results mainly from good faith in business relationships, and in some cases only by substantially winking at the law.

Somewhat analogous difficulties had developed with regard to par value shares. A section in the New York Stock Corporation Law states one legal concept with respect to the liability of stockholders to creditors, a legal concept almost universal (with variations) in American law, namely: "Every holder of shares of stock not fully paid shall be personally liable to the creditors of the corporation, to an amount equal to the amount unpaid on the shares held by him for debts of the corporation while such shares were held by him." 9 Not all decisions, by any means, attach liability to innocent holders who may happen to have such stock when the corporation incurs debts it cannot pay; but liability on the stockholders is almost everywhere imposed by law; and even with the above mitigation it has often been used as a sword for unjust enrichment.10 As a rule of law, it had elements of great harshness,

9. N. Y. Stock Corp. Law § 70. As to the creditor's remedy, see, for example, Jeffery v. Selwyn, 220 N. Y. 77, 115 N. E. 275, 277 (1917); and Bottlers' Seal Co. v. Rainey, 245 N. Y. 333, 153 N. E. 437 (1926).
some of which were gravely injurious even to thoroughly honest organizers of corporations.

Such harshness grows more evident as one pursues the definitions of "amount unpaid on the shares." When stock is issued for cash, there is, to be sure, no difficulty in determining whether or not it has been "fully paid for." Courts have rather consistently held that the giving of a promissory note is not actual payment, and that a debt due on unpaid subscriptions to stock may not be offset against debts owed by the corporation to the stockholder, decisions as to which the justice is virtually self-evident. Even for an innocent stockholder, in jurisdictions where liability extends to him, there is little risk in this principle today, because the Securities and Exchange Commission now requires the full disclosure of such facts, if any; and imposes on corporate officials a full liability to investors who suffer loss because of misrepresentation.

A very large portion of the stock issued in promoting a corporation, however, is put out in payment for property, both tangible and intangible, and for services. That these may be legitimate objects for purchase in this way is obvious. That they lend themselves readily to over-valuation by the parties involved is equally obvious. Indeed, everyone who has had anything to do with the valuation of real estate and the appraisal of other properties was in the beginning shocked and surprised at the enormous divergence of the figures given by "experts" seemingly of equal experience and background. If one were to take a diamond ring into a jewelry shop, for example, and ask information as to its value, the answer would vary enormously according to his apparent purpose as prospective purchaser or would-be seller, to say nothing of differences as between one appraiser and another.

It accordingly follows that even in the very best of good faith and objective judgment, the "value" ascribed to such assets, important and necessary as they frequently are, is certain to meet with little agreement on the part of others, if at any time brought into court for scrutiny. This is particularly conspicuous when such scrutiny occurs in time of financial trouble, after all the intangible elements of value present in the hopeful minds of the organizers have been squeezed out by the subsequent unhappy history of the enterprise. Yet that is the situation which confronts every corporation, and its stockholders, in the event its creditors fail to get paid in usual course and accordingly set up a claim founded on alleged failure to pay in full for the stock

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(1892). Here the court invented the "fraud doctrine," because otherwise the plaintiff judgment creditors would have misused the law to their immense financial advantage.

when it was first issued. In the shadows of insolvency it is regrettably difficult to discriminate between over-valuation as of the time of the stock issue, and the mere appearance of over-valuation due to change of conditions afterward.\textsuperscript{14}

Aside from this difficulty as to "full payment" of the par value of stock, it has the further defect of actually misrepresenting in any case the money value of a corporation's capital after even a comparatively brief period of active operation. There may have been, perhaps, a substantial equivalence at the beginning between the total par value of all the shares issued, and the money value of all assets paid in by the purchasers of those shares; but the value of net corporate assets fluctuates up and down with every year that passes, while the total par value of the original stock remains unchanged. Losses often occur during such disastrous years as those of the 1930's—but, in the absence of a vote by the corporation, there is no change in the par value of its stock. Assuredly, then, there is nothing to be said for par value as an accurate or valuable measure of the real financial worth of a company, even if the strictest concepts of the law were complied with at its inception.

Growing out of this inevitable divergence, between par value of the stock and net value of currently owned assets, there developed another difficulty for corporations after a depression or other disaster had seriously depleted their assets. When the storm is over, an additional supply of fresh capital is often urgently needed; but the par value concept stands in the way. The old stock may be worth no more than fifty cents on the dollar, as a mere consequence of the erosive effects of depression; yet under the law new par value stock of similar kind cannot legally be sold for less than par. For example, if 20,000 shares of $100 par value were presently outstanding, but with capital assets now worth but $1,000,000, purchasers (if any) of 10,000 additional shares at $100 would contribute half the total capital while getting only a one-third interest in assets and earnings. This, of course, investors would not often do. Thus, the corporation's only way out was to revise its internal stock structure, a complicated matter commonly productive of costly litigation among stockholders, followed by a sometimes almost ruinous hospitalization at the hands of bankers and its own committees of stockholders and bondholders. It is truly a serious matter when law needlessly forces the equivalent of an internal revolution on a financially weakened corporation before it can offer new securities on terms acceptable to investors.

A third difficulty, though one which may not be quite so apparent to some readers, arises from the very practical necessity of compensating the

\textsuperscript{14} In some states the courts apply what is known as the "true value" rule, in which case the good faith of the organizers is not even taken into consideration in determining whether or not a stock issue is "fully paid for." The "true value" rule was applied in Illinois prior to the adoption of its present corporation act. Strickland v. Washington Bldg. Corp., 287 Ill. App. 340, 4 N. E. 2d 973 (1936). Missouri and Massachusetts still apply the same rule, but good faith, and absence of fraud, are legally important in such states as Ohio, California, North Carolina, and Oregon.
promoters who organize a corporation. Individuals who have the personality, the contacts, the "know-how," and the creative imagination to visualize the process of transforming inert economic conditions into an active and wealth-producing enterprise, and to carry it through to realization, are distinctly rare. Business men, of course, understand the indispensable nature of their ability, and are prepared to reward it liberally. According to one distinguished observer, "Custom seems to have decreed that about 10 per cent of the common stock is a fair compensation to the promoter if he merely conceives the enterprise, and renders only advisory services to the banker who forthwith assumes the constructive activities of promotion. Where the promoter combines the functions of inventor, promoter and banker, he may even take 51 per cent of the entire capitalization as his compensation." To provide this compensation—without which there would come about a great depression in the creation of new enterprises—has accordingly been one of the problems which legal doctrine has made difficult and at times exceedingly dangerous. Some restraint is undeniably desirable, when optimism and greed are united with chicanery; but the par value concept of "full payment" can be both obstructive and unfair.

Oftentimes, too, the consideration actually paid for stock is much larger than appears on the corporate records. For example, in one case the incorporators conveyed certain mining claims to a corporation for its entire capital stock of 1,000,000 shares with par value of $1 each, plus $50,000 in money, and then, regarding the stock as "fully paid and non-assessable," they returned 750,000 shares to the company as "treasury stock," for use in financing the undertaking. Using this stock as a bonus, the company sold an issue of $200,000 in mortgage bonds, and disposed of other shares at from 25¢ to 45¢ per share; and from these proceeds it entered actively into the business of mining its properties. Commonplace as such proceedings were in times gone by, and complicated as they were, they assuredly did not, of necessity, involve wrongful intent or wrongdoing of culpable quality; and in this case the incorporators actually retained for themselves only 250,000 shares out of the 1,000,000 ostensibly received for their properties. Unquestionably, stock can be issued below par by this process, and it has been so issued. The creditors in this case, however, plaintiffs in a tort action against the company, were claiming a discrepancy of $1,050,000 minus the "real" value of the property against which the stock was issued, without even considering the proceeds from resale of the shares. By ruling out the realities of those later resales of stock by the corporation, it becomes possible to argue

16. In Du Pont et al. v. Ball et al., 11 Del. Ch. 430, 106 Atl. 39 (1918), stock issued for promotional services was held to be "fictitiously and illegally paid for"; and judgment was had against the promoters for their "unpaid subscription."
very convincingly that mere donations of newly issued shares to the treasury for resale by the corporation, or for use as bonus with bonds, is evidence of intent to "overvalue,"18 which, doubtlessly, it is, within the legalistic viewpoint now under discussion. Such donations reduce, or may completely extinguish the "overvaluation," if any; but in law they are made to look like a confession of guilt.

It was accordingly against such difficulties as these that even the most conservative of financial lawyers felt an imperative need for relief; and, of course, it was quite natural that they should have the support also of brethren of the bar who fed in other and less reputable financial pastures. Such difficulties help indicate the accumulating force which lay behind the first authorization of no-par stock in New York in 1912, and the more liberal authorizations which spread rapidly among the several states. With those rough edges of par value stock freshly in mind, one can more intelligently appraise the opposition to no-par stock, and in that way more readily understand its present status in law and in finance.

**TWO POSITIVE MERITS EVIDENCED BY NO-PAR STOCK**

The immediate need, however, seems to consist in recapitulating and examining some of the advantages attributed to no-par stock, other than those already implied in previous discussion.

One advantage is freedom from misrepresentation. No-par stock does not purport to express the definite money value of those properties, qualities and other assets which go to make up the corporate property as it was when incorporated. It has already been shown that many items go into most business corporations for which an exact money measure is impossible. Nothing but the mind of a sophist would even pretend, if truth be told, that the true and accurate money value can be given for such things, for example, as a new and untried patent; or a secret process expected to reduce the cost of producing some standard product; or the sprawling buildings and machinery which make up the property of a defunct industry about to be infused with a new injection of money and managerial skill. Further, it is one of the virtues of no-par stock that no such attempt is made. Instead, it merely represents—with the aid of the issuer's annual reports and/or its initial prospectus as filed with the Securities and Exchange Commission—that ownership of the company is divided into a given number of shares, and that the holders of those shares have participation in its management and in its distributed earnings in proportion to their holdings.

Another advantage is sometimes asserted, with considerable logic, as a

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corollary to freedom from misrepresentation. It may very well have social
significance in helping clear up the unhappy causes of suspicion which at
present cloud the truth and organization of business corporations. To comply
with the rules laid down for par value stock is seemingly simple. In the very
nature of things, however, the attaching of monetary values to all the ele-
ments being brought together involves mental dishonesty, however free the
parties are of anything approaching fraudulent intent. That process, accord-
ingly, as nearly everyone knows, calls on lawyer's clerks, acting as directors,
to "appraise" property without personal knowledge of its nature or value,
with no background of judgment or experience in such appraisals, and with
no freedom of action in any case. They simply sign on a dotted line, and their
flan may bring into legal existence millions of securities which must by law
be assigned some arbitrary money value.

The process itself, without regard to the probity of the principals in-
volved, smells of smoke-filled rooms and provides demagogues with ample
materials for damaging and destructive suspicion. Ridding corporations of
the requirement for these fictitious valuations would leave the picture little if any
more complicated than that of any joint venture, simple and as understandable
to workingmen, perhaps, as their own membership in a union. Labor's sus-
picion as to the honesty of corporate accounting might not be wholly allayed,
of course, by discarding the fictitious valuation of things without fixed value;
but surely a shift over to simple honesty in this one important thing would
help workers and investors alike to have more confidence in reports relating
to operating costs and earnings.

Present Status of No-Par Stock in the Law

Only by indicating the present status of no-par stock under the law
can one intelligently appraise the objections which have been so strongly
offered to this relatively new corporate development. First among those ob-
jections, it will be recalled, was the charge that it stripped creditors of the
protection they had enjoyed through the liability of holders of par value stock
for any unpaid part of their stock subscriptions.

Taken as a whole, this charge contains one implication highly unwar-
ranted by the state of the law with respect to par value stock and its holders.
Despite the many cases reported which have had to do with unpaid stock
subscriptions, and the resulting liability of stockholders on that account, it
remains true that competent lawyers were well aware of methods open to
large corporations which, if made effective in practice, were generally re-
garded by the courts as protecting stockholders from liability to creditors.
Indeed, were this not so, even the innocent acquisition of corporate stocks in

some jurisdictions would have become precarious to the point of almost complete discouragement of such purchases; because stock would include the possibility of future assessment on account of unknown acts performed by unknown incorporators at some unknown time in the past! Practically speaking, then, stockholders have not often been held liable to creditors, and by this token the creditors were left outside the pale, except in some cases where dependable legal advice was not had, or was not followed.

One great danger to the promoter, at times, arose from his attempts to realize a profit without impairing the sale of stock through overly-frank disclosure; and those profits were not always reasonable or commensurate with the services really performed. Since the law was normally blind to this question of compensation, in any event, the process of protection was as important to the modest promoter as to the extortionate one. After the exciting but contradictory results of two cases arising out of the promotion of the Old Dominion Copper Company,20 such promoter protection was found in a simple process which estopped the corporation and all subsequent stockholders from questioning the adequacy of consideration.

Prior to the enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934, accordingly, any challenge from corporation or stockholders was cut off if the directors on one side, and the promoters on the other, in full knowledge of the facts, made a deal for the transfer of property and services to the company in return for all of its capital stock. That the directors were normally "straw men" made no difference in legal effect, since everyone having any interest in the company and in its stock was fully informed, and became thereby a party to the transaction. Having in this way estopped the company as such, and subsequent purchasers of stock, from bringing suit, the promoters then would give back to the company as much of their stock as seemed needful, and this "treasury stock" was salable to the public without risk of promoter liability to stockholders.21

Under the Securities Act and the Securities Exchange Act, mentioned previously, innocent stockholders are no longer estopped in a proper case by the knowledge of predecessors in title; and, subject to the terms of those statutes, they may now sue in cases where they would previously have had no cause of action. The filing of a registration statement by the company,

20. Old Dominion Copper Company v. Bigelow, 188 Mass. 315, 74 N. E. 653 (1905); Old Dominion Copper Company v. Lewisohn, 210 U. S. 206 (1908). In the latter case, Mr. Justice Holmes denied recovery against the promoter, asserting that all stockholders and corporate officers were aware of the transaction and that no one had been wronged because of it.

21. Usually it was sold at a discount. In Piggly Wiggly Delaware, Inc., v. Bartlett, 97 N. J. Eq. 469, 129 Atl. 413 (1925), however, the same process was followed with respect to an issue of no-par stock. A franchise costing $1,000 was sold to the corporation, and the shares were then sold to the public for $100,000; the promoters pocketed the net proceeds. The company brought suit for "secret profits," but was defeated. Defendants relied mainly on the no-par statute, but the decision accords nevertheless with earlier decisions elsewhere based on the Lewisohn case, supra note 20.
however, in conformity with the requirements of the Securities and Exchange Commission, is clearly intended to provide public notice as to all organizational facts material to the promotion. Concealment of a material fact exposes the responsible parties to liability for resultant loss by innocent stockholders. By the same token, inclusion of all such facts, including the amount of consideration received for stock, therefore, would seem necessarily to serve as legal notice thereof to all the world. If this common legal doctrine be applied consistently, then no clear legal need for the rather farcical proceedings described above would seem now to exist.

This process, moreover, was at one time thought somehow effective also as a protection against stockholder liability to creditors. Assuredly the stock so issued was clearly labeled "fully paid and non-assessable." On the other hand, many state statutes expressly imposed stockholder liability to creditors for any "unpaid part" of the purchase price of the stock, much as was noted previously in the New York Stock Corporation Law. Some courts, nevertheless, construed these statutes not to apply to innocent purchasers for value. Others were decidedly unwilling to impose liability on business promoters who had actually transferred something of real though indeterminable value to a corporation in return for stock. It is quite possible, however, that these questions may have been settled definitely and perhaps with considerable wisdom by the Securities Act and the Securities Exchange Act. If the registration notice be regarded as public notice of facts contained therein, then it ought to be and could be regarded in the law as notice also to creditors. In that case, creditors would have recourse against stockholders only in those cases where a material misrepresentation of facts had been incorporated into the registration statement, and because of such misrepresentation the creditors had been misled to their financial injury.

From the business man's standpoint, there is no hardship whatever in a limitation of this kind. It is simply poppy-cock, invented by professors and by judges with no real knowledge of business practice, to imagine that large businesses (other than financial institutions such as banks and insurance companies) receive any important amount of credit from vendors merely on account of the capitalization figures shown on a letter-head. Were that true, why the almost universal reliance instead on Dunn & Bradstreet's reports, for relatively minor credit extension, and on signed statements of condition when bank loans to relatively unknown firms are under consideration? The

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22. See Ballantine, Stockholders' Liability in Minnesota, 7 Minn. L. Rev. 79, 89-92 (1923). Ballantine recognized but bitterly attacked the doctrine.
23. N. Y. Stock Corp. Law § 70; see also text at note 9 supra.
ordinary seller would probably not refer to the registration statements of a
corporation, as a basis of credit; but these undoubtedly are open to the credit
reporting agencies on which the seller mainly relies. To whatever extent such
statements are deemed material in this extremely useful and practical business,
accordingly, they would be taken into account when credit ratings are pre-
pared. Here, then, is a situation which should put an end to that sort of
creditor lawsuit which seeks an unjust enrichment without reference to real
equities.

Aside entirely from the ultimate fate of the author’s foregoing views as
to what future decisions ought to be, now that registration statements are
required of all but the smaller-sized and purely local business corporations as
they issue new stock or are reorganized, there should be made a comparison
between the status of par value stock and no-par stock in regard to liability
to creditors. In this connection we are already aware that consideration is
required for the former and in theory, at least, it must be measured by that
total par value of the issue. If consideration is also required for no-par stock,
and if there is some way to measure actual as against purported consideration,
it follows that an eagle eye indeed would be required to discover reasons why
no-par stock should not be subject to liability to much the same degree as
par value stock is for unpaid subscriptions.

In most jurisdictions, including even Delaware, the happy hunting ground
for corporate organizations, some actual consideration is required for no-par
stock issues.26 When nothing was paid for the stock, some courts have merely
decided, in accord with a widely known decision of the federal courts,27 that
the no-par stock is not valid and accordingly imposes no liability of any sort
on its recipients. In the above decision the court remarked, although it would
appear to be obiter dicta, that “the generally, if not universally, accepted
theory of the purpose of such statutes (authorizing no-par stock) is that they
are intended to do away with both the ‘trust fund’ and ‘holding out’ doc-
trines. . . .” Whether or not that was the intent, nothing is found in the
statutes themselves to strip injured creditors of a remedy when and if there
has been an overvaluation of what was paid in for stock. Even statutes like
the Massachusetts one, partially quoted above, do not leave such creditors
without remedy, though doubtlessly a different one.

Probably nowhere has the underlying theory involved in this argument
been more acutely and effectively stated than by Adolph H. Berle.28 Without

28. STUDIES IN THE LAW OF CORPORATION FINANCE (1928).
following his argument slavishly, it may be stated that there are three major kinds of no-par stock, namely:

(a) Where a stated value per individual share is required;
(b) Where a stated value for the entire issue is required;
(c) Where valuation by directors of the paid-in consideration is not required.

In cases (a) and (b), a microscope would hardly suffice to find any essential difference between no-par and par value stock from the standpoint of either the "trust fund" or the "holding out" doctrines on which stockholders' liability has mainly been worked out. Courts could, to be sure, be guided by the language quoted above from the Johnson v. Louisville Trust Company decision, and, if so, might in that way draw a highly intangible line of demarcation. The courts could in that manner take advantage of the no-par statutes to move away from a doctrine which to many lawyers has seemed based mainly on a fictional hypothesis as to the supposed influence of stock capitalization in the matter of securing credit. During perhaps the first year of existence, mere magnitude in ostensible capital might induce a giving of credit in small amounts by small firms; but substantial and also subsequent credit is normally based on information deemed more objective. If these no-par statutes encourage more realism on the part of the courts, well and good; but no such change is required, or even implied, in the case of no-par statutes of types (a) and (b).

Some courts have already decided that stockholders' liability persists under no-par statutes when stock payments are overvalued. In Livingston v. Adams, for example, the Missouri Court of Appeals had under consideration a no-par stock issue under a statute which permitted the incorporators to issue the same "for such consideration" as might be prescribed in the certificate of incorporation; it was provided also that the said certificate must set forth the amount of capital with which the corporation would begin business. The amount specified by the incorporators was $5,000, whereas the court said that actual consideration was but "a fractional part" of such amount. In a suit by the creditors, the discrepancy having been proved, the court proceeded to apply the old "trust fund" doctrine of liability, just as it had been developed in cases where unpaid-for par value stock was involved.

Sometimes the requirement for setting forth the money value of capital is imposed by indirection; and it could easily be overlooked by lawyer and client when considering such questions as stockholder liability. For example, in Delaware a provision is found fixing at $1,000 the minimum amount of capital with which any corporation may begin business. In that state, accordingly, any issue of no-par stock—if it be the only issue—would neces-

29. 226 Mo. App. 824, 43 S. W. 2d 836 (1931).
sarily be a watered stock unless paid for with money or property and services having a value of $1,000 or more.

No one can predict with assurance, of course, what a particular court will decide in no-par stock cases, when first confronted with a creditor's attempt to assert stockholders' liability on the grounds of unpaid-for stock. When the statute, however, in one way or another requires the incorporators to place a dollar value on the capital paid in for such stock, or a minimum dollar value, it does assuredly provide the court with a yardstick against which actual consideration may be measured. Having done that, it sets up a situation essentially analogous to that created by the issuance of par value stock; and if there is a discrepancy between real and ostensible value the legal status of the stockholder normally in either case is essentially the same.

Thus, in legal logic, at least, the authorization of no-par stock need not, and probably in most cases will not, strip the creditor of that protection which he had been accorded before; at least, not in those cases where a dollar value must by law be ascribed to the property paid in for the no-par stock. Nor, as will promptly be noted, does this necessarily imply freedom from a very similar liability even when no statement of capital or other value is required in the incorporation papers.

**RISK IN THE VALUING OF ASSETS**

Unhappily for those looking for freedom from risk in the issuance of no-par stock for consideration of dubious value, the absence from a no-par stock statute of any valuation requirements does not remove the incorporator from the horns of his valuation dilemma. Some estimate of the money value of these assets must unavoidably be made for accounting purposes; and, also, in those states where such discretion is allowed, for the purpose of designating how much is attributed to capital and how much, if any, to “paid-in surplus.” Such estimate of money value is also highly important for the purpose of fixing the issue price of the shares; otherwise there would be no yardstick available in the future for the guidance of directors in issuing additional shares for cash, an anchor to windward which might be of great value to directors if sued on the grounds that the cash price was so low as to constitute a dilution of the original shares.

Aside from the pressure of such needs as are felt by the incorporators and the corporation directors, when setting up their own books, the Securities and Exchange Commission itself requires every registration statement to contain data showing the corporation's authorized and paid-up capital, the number of classes of shares representing it, and either the par value or the stated or assigned value of such shares; and if there is a “surplus” account,
then, any part of it representing "paid-in surplus" must be shown separately.30

Moreover, such statutes as the very "liberal" one of Massachusetts, the Business Corporation Law,31 require annual statements of condition by every corporation; and these must be signed and sworn to by the president, treasurer and a majority of the directors of every corporation. In that annual statement must appear a dollar valuation of all the corporation's assets and of all its liabilities. In the absence of par value shares, net assets will be shown by the balances in Reserve and Surplus Accounts, plus Profit or minus Loss. The first annual statement after incorporation could not be made without some starting figure indicating the original money value of assets received in payment for the stock.

It seems quite evident, therefore, that if the subscribers or incorporators merely exchanged something unvalued for so many shares of no-par stock, even when there is no direct requirement in the no-par stock-authorizing statute as to the fixing of value, there would nevertheless be little difficulty afterward in discovering whether or not it had been given a "fictitious valuation." Then, if there had been, the directors and the officers signing a false statement could be held liable to creditors relying on their sworn statement of condition. As this could be an action sounding in tort, any one of the tortfeasors could be made liable for the whole injury established by the creditors, and in that case would have no right of contribution as against his fellows. This, then, is a risk which well-advised business men are not likely to undertake lightheartedly.

The mere valuing of assets, for necessary business purposes, therefore, involves serious perils when money value is indefinite and difficult to establish. Even in this case, Bonbright's fear of stripping creditors of needed protections is enormously exaggerated; so much so, in fact, that the real problem lies in giving protection to honest promoters and organizers against those who seek to misuse the law on the creditor side. That problem will be taken up presently.

Dilution of Stockholder's Equity

Another sharp criticism directed at no-par stock, which should be taken up before investigating the particular advantages and disadvantages of no-par stock for the organizers of a new corporation, is its alleged adaptation to improper and even fraudulent dilution of the value of prior stock issues. This dilution of value was expected to occur through the sale of later issues at an unduly low price in comparison with the real value of pre-existing stock held by outsiders. One of the purposes of no-par stock was to permit new shares to be sold on proper occasions at substantially reduced prices;

31. MASS. GEN. LAWS, c. 156, § 47 (1920).
but in the absence of equitable controls, this privilege offers an inviting opportunity to unscrupulous directors. By offering new stock to “insiders” or favored groups, quick stockmarket profits can be made; or an undue share of earnings in relation to invested funds can be realized; or voting control can be shifted at a minimum cost. The most friendly critic will admit that such activities have not been conspicuously absent from certain financial quarters in times gone by; but these things are really serious only on the assumption that somehow they are beyond the pale of legal control.

As Berle has intelligently pointed out, however, the recognized principles of equity are not repealed by the no-par statutes. To the extent that law has been accustomed to regard the directors and the promoters of a corporation as charged with the responsibilities of trustees, they continue and doubtless will continue to be so charged. Those responsibilities have not been lightly regarded by the courts.

For example, when a contract is entered into between two corporations which have certain men common to both boards of directors, it has been held voidable if unfairness to the corporation appears, in which case the voting or not voting of the directors directly interested is not decisive. Under some relatively new statutes on corporation law the participation of an adversely interested director in the making of a contract makes it neither void nor voidable if openly made and ratified by other directors or the stockholders, or in any case if it be just and reasonable at the time. There is, however, no relaxing of the duty on the part of an adversely interested director to deal fairly with his corporation.

Even in the matter of salaries it has been held that executive officers who are also directors may not vote themselves a raise in pay in the absence of sound and valid reasons; and if they do so it may be recovered by the corporation. Hence, it should not be surprising to learn that unfair dilution of existing stock values, through subsequent sale of like stock at an unduly low price, is frowned on by the courts.

For example, in Bodell v. General Gas & Electric Corporation, the Chancery Court of Delaware was asked to sustain an injunction against the issue of no-par stock at $25 when its book value was greater than that, and its market value was about $45 per share. In this particular place the bargain-like price applied only to owners of common stock Class A, and was limited to the reinvesting of dividends received on their respective stockholdings. This, the court found, was intended by the directors to aid further expected financ-

36. 15 Del. Ch. 420, 140 Atl. 264 (1927).
ing needs of the company by making Class A common stock attractive to investors and was untainted by fraud on the part of the directors. The opinion said: "The mere showing of the two prices would without satisfactory explanation undoubtedly entitle the complainants to relief. But if . . . justified by a showing of fairness in the light of all the circumstances so that what appears to be an injury turns out to be a benefit to those complaining, there can be no ground for interference." (Editor's Note: This opinion was that of Chancellor below approved by the court and quoted in opinion.) To the same effect was a decision in the Third Circuit Court of Appeals.87

Understood and applied in this way, the freedom given directors in fixing the price of no-par stock is found not to be absolute, as was apparently supposed and feared by some. It strikes off the shackles long imposed by the legal fiction of par value as a fixed and immutable price, but at the same time leaves untouched the more pervasive and necessary rules of equity as these affect the actions of corporation officers and directors. When no-par stock issues are outstanding, and additional shares are authorized, the raising of new funds need no longer be attended by technical adherence to fictitious concept, or be deferred until after a decision has been had on the needless dog-fight between factions which almost invariably springs up before some new preferred stock issue can be given enough precedence over existing stocks to make it marketable. Whether or not this additional freedom is calculated to work out for the greatest good of the greatest number will remain, to be sure, a question on which almost endless debate could be had. But, to the extent that other courts follow the two cases just cited, it is evident at least that mere arbitrary manipulation of no-par stock prices, for the benefit of the directors or their friends, will not encounter fair seas when they reach the courts.

THE INFLUENCE OF WEIRD TAX DISCRIMINATION

Despite the failure of no-par stocks to give incorporators and promoters as much protection as they had hoped for, perhaps not even as much as they feel honestly entitled to, it is still true that such stock issues have brought them many attractive gifts. One would accordingly expect virtually all recent financing to have involved their use. But this is not the case—and for a very good reason indeed. Advantages made available at the hands of no-par stock statutes have, in too many cases, been more than offset by disadvantages imposed by tax statutes.

Taxes apply to stock issues not only at the time the stock is issued, but

87. Atlantic Refining Co. v. Hodgman, 13 F. 2d 781 (C. C. A. 3d 1926), wherein the court said: "... While an arbitrary sale of the same issue of stock at different prices to different persons would not be sanctioned, such differential sales will be sustained, if based on business and commercial facts which, in the exercise of fair business judgment, lead directors to follow such a course."
also on every transfer of shares from one owner to another; and the taxes imposed on no-par shares are determined in the main at so much a share by both state and federal tax levies, while those on par value stock, however low the par value may be, are imposed mainly on the basis of so much for each $100 of par value.

Translating these taxes into concrete figures, let us take a Massachusetts corporation having a capital of $66,500. If that capital is represented by 10,000 no-par preferred (valued at $60,000), 10,000 no-par Common A, at 50¢ per share, and 10,000 Common B, at 15¢ per share, taxes on the original stock issue would be: Massachusetts, $300; Federal, $900; a total of $1,250, or almost 2¢ on every dollar of capital. If represented entirely by stock with par value, however, the same taxes will amount to only $123.15.

Turning now to the stock transfer tax, let it be assumed that sales in one year are equivalent to as many shares as were issued in each class of stock. In that case, the transfer taxes on those sales, if represented by no-par shares as stated in the preceding paragraph, would amount to $1,500—or more than 2 per cent on their aggregate value; but if par value shares are used, instead, those same taxes would be approximately $53. Granting that the example is somewhat extreme, it nevertheless indicates that substantial money savings are effected, under existing tax rates, through the use of par value instead of no-par value shares.

Even these illustrations do not reveal the full story, which is well known, of course, within the financial world. There is another facet to this interesting tax situation, a facet growing out of the privilege of allocating some portion of the proceeds of a stock issue to "paid-in" surplus. This privilege, though commonly thought of as particularly appurtenant to no-par shares, is not limited to them. In the case of par value stock the proceeds from each issue must all go into "capital" account up to the point of equivalence with total par value; but if shares are sold above par, the excess may normally be allocated to "paid-in" surplus almost as a matter of course.

This fact, in large part, explains the great preference developed in relatively recent years for par value shares of such low denominations as $5, $1, and even less. When no-par shares of a large company can be marketed, for example, at $10 a share, the tax situation offers great advantages in putting shares out at $1 par value. Investors these days are little influenced by the par value imprinted on each share, but look instead to earnings or speculative prospects. Hence, the $1 par value shares can be sold for $10 with no more difficulty than if they were no-par. And the tax advantages are astonishing.

On the sale of a million shares as no-par stock, for example, the transfer tax in a state like Massachusetts would be 2¢ a share to the state, and 3¢ per share to the federal tax collector, or $50,000 all told; but if sold as $1 par
value stock, the combined transfer taxes would be but 8¢ for each $100 of par value, or only $800 on the same number of shares.

It is difficult to penetrate the clouded convolutions of legislative thought which gave birth to such monstrosities as these in tax discrimination. Perhaps they are largely due to the violent attacks on no-par stock made a few decades ago, from which distrust was doubtlessly deeply distilled into many minds. Entirely too few persons, even in the legal profession, are as yet aware of the legal developments which so largely have cut away the basis of those attacks. Possibly they represent merely an accident in thought formulation, which may shortly be corrected.

From the standpoint of investor and public welfare, it is difficult indeed to find any real reason for even a modest tax discrimination of the kind noted. Can anything material be said against no-par stock which might not also with equal force be said in opposition to low par stock? Have subsequent legal developments tended to make low par stock in any degree more conducive to the public welfare than no-par stock? The author is not aware of any existing body of opinion which would undertake to justify the discrimination. He doubts if even within the ranks of tax assessors, where ease of assessment would naturally be welcome, there would be any of sufficient mental indolence to prefer ease of assessment to practical honesty and fairness. The discrimination in favor of low par stock is stupidly and heavily at variance with the comparative realities involved in the two kinds of stock.

Resting solidly in the sound and basic needs of public policy, on the contrary, are two related facts which favor no-par stock as against low par stock issues. Primarily this advantage lies in the freedom of no-par stock from misrepresentation as to corporate assets and capital, a misrepresentation which is endemic with any par value practice. In an era when truth-twisting propaganda has almost melted away the starch of simple honesty in statement, the law at least should not be enlisted in furtherance of chicanery. For tax discrimination to reward false faces in corporate accounting, in fitting figures to par value stock strait jackets, as at present, seems intolerable. This wearing of false accounting faces by par-value stock issues is, moreover, an open invitation to demagogues. These termites eat away the sills of national unity, and replace them with distrust of the entire capitalistic system and with rising class hatreds, much more easily on account of complicated black-magic in corporate capitalization, a black-magic powerfully encouraged by the existing tax structure.

Given appropriate tax reform, this highly dubious development would undoubtedly come to an abrupt ending and an about-face. Aside from these real but unwarranted tax advantages, business firms and corporation lawyers have no reason to continue favoring low par over no-par stock. Doubtlessly conservative old firms, which have thus far resisted the blandishments of
NO-PAR STOCK—ITS NATURE AND USE

temporary advantage and still cling to the $100 par stocks with which they long ago began business, will in many cases adhere to a policy which marks them as inheritors of a successful past. Firms with less regard for tradition, however, will normally favor no-par stock because of its simplicity, its freedom from misrepresentation, and the flexibility it offers in meeting new conditions and emergencies. The simple elimination of gross discrimination in stock taxes would in this case, accordingly, strongly tend to promote the best interests of corporations, to lift tax legislation to higher levels of public respect, and to serve the best interests of the public in other important ways.

RISK REDUCTION IN ASSET VALUATION

Whatever form a corporate organization may take, however, counsel will need to know the risks previously pointed out, and to provide his clients with means for reducing those hazards so far as he can. No brief is offered here for lawyers who may look hungrily toward a lucrative practice in behalf of "bucket-shop" security dealers and piratical promoters; but these are not the only ones exposed to danger on the side of asset valuation. "Fictitious valuation" and "secret profits" are allegations easy to make in the dark period when business disaster overtakes a new venture, and in that darkening period it is by no means easy to make visible to unsympathetic eyes even the most honest of expectations which at the beginning had illuminated the project.

It is perfectly proper, accordingly, for a lawyer to ask his client point blank if the proposed valuation of property (other than money) is low enough to be defended in court in case of financial difficulties. Further, no client is necessarily subject to any implication of bad faith if he admits that such defense might under possible circumstances be very difficult. There is seldom any persuasive reason why an organizer's property and services should be turned over to a corporation for stock, unless given a rather generous appraisal in terms of stock. Despite all the fictions of the courts, a seller will nearly always accept less in cash than he will in stock, as payment for property or services.

Except in the rather unusual cases where future valuation scrutiny is deemed wholly without peril, therefore, certain precautions are suggested. In most states these precautions are relatively simple, impose no onerous conditions, and can be taken in connection with either low par or no-par stocks. In those relatively few states which permit no "paid-in" surplus to be set aside from the price received for no-par stock, however, the careful lawyer would advise his client to make use of low par stocks; because there is no such restriction on these if the "paid-in" surplus represents consideration received over and above the par value of the stock.

The precaution itself consists in dividing the valuation of things turned
in for stock into two parts, one being allocated to "capital" and the other to "paid-in" surplus. The value attributed to capital is the only part likely to be measured against consideration paid in, in the event of a later assertion of "stockholders' liability" for allegedly "unpaid stock"; and it should accordingly be small enough to avoid that danger. For example, if such consideration could not reasonably, under any circumstances, be appraised below $200,000, then the amount allocated to "capital" should be fixed accordingly; but if its fair value seems to be $500,000, that much could be ascribed to the consideration as a whole, with $300,000 allocated to "paid-in" surplus.

So far as liability on the grounds of "unpaid-for stock" is concerned, the above process seems entirely adequate—though it does not deal satisfactorily with that kindred liability which grows out of a corporate overvaluing of assets as a misrepresentation of its financial position.

Stockholders' liability for "unpaid stock" has been imposed on the theory that stated corporate "capital" is in law a "trust fund" for creditors, or else a representation to creditors that the stockholders had in the beginning contributed assets to the value set forth as "capital," and that any watering of the stock is a breach of duty to creditors. Corporate "surplus," on the contrary, is everywhere known to be in the nature of a fund primarily for the benefit of stockholders as distinct from creditors. The "trust fund" doctrine could not, therefore, logically be applied to it at all; and the "holding out" doctrine, to the extent that it might apply, would logically take on the nature of a suit involving alleged misrepresentation of financial condition to prospective creditors. It is indeed difficult to see how liability could be established without good evidence of the creditors having been in fact misled; and the writer is not aware of any cases where stockholders' liability as such was imposed on account of "paid-in" surplus.

In some states law does not permit any consideration paid for no-par stock to be attributed to "paid-in" surplus, in which case the above process is not open in connection with no-par stock; but low value stock with a par value is in that case still available, and all it requires is the fixing of par value at a price consistent with some money value which may safely be ascribed to capital.

Danger arising from "inflation in the balance sheet," on the other hand, is the creature of a realistic legal concept. In Massachusetts, as explained in a previous section of this article, business corporations are required to file each year with the commissioner of corporations "a report of condition which shall be signed and sworn to by its president, treasurer and a majority of its directors." If value placed on corporate assets of any kind, including those paid for in stock, is inflated beyond their legitimately acceptable valuation, the statement of condition involves much the same financial liability on the

38. Supra note 31.
part of its signers as would result if they were to deliver the same statement of condition to their bank as a basis for securing bank loans. It is then a misrepresentation of financial condition, and those misled to their injury have a right of action against those responsible. Innocent stockholders, of course, would be in the clear, but signers of the statement and others who have knowingly participated in the fraudulent act are liable under the law.

If no-par stock be used in the stock issue, however, it is by no means necessary in practice to set up a balance sheet inflation; at least, not if the incorporators have merely the honest but extra-legal purpose of using stock to pay for promoter and other intangible services and values incident to organizational activities. It is perfectly possible to sell blocks of no-par stock at different prices to different groups, especially if some good business reason can be given, or if the buyers at higher prices know and impliedly accept the difference.

For example, the “promoter’s stock” could be sold for a purely nominal price—perhaps 10¢ a share—and those who were actually putting up the money could then purchase their own shares at such price per share as would give them and the promoter an agreed proportion in ownership, and the corporation the agreed amount of real capital. Perhaps the more traditional way to accomplish that end would be for the contributors of real money to purchase all the shares of the corporation, at any suitable price per share, thus making the shares “fully paid and non-assessable.” Afterwards they could transfer the agreed portion of their shares either directly to the promoter or back to the corporation which, in turn, might then sell them as “treasury stock” to the promoter at any nominal price. In such case there need be no inflation in the balance sheet and none in the “capital” account.

The foregoing protections are described in terms which indicate their effectiveness in the case of “closed corporations.” No matter what kind of business corporation may be involved, they offer a high degree of protection against such things as “shareholders’ liability” and “balance sheet inflation” liability to creditors; this is virtually the only kind of liability which arises in the organization of an ordinary “closed” business corporation. If sales of securities to the general public are involved we still have the rules of the Securities and Exchange Commission to take into consideration, in connection also with possible “promoters’ liability” to stockholders for secret profit, and liability to stockholders under the principle of “equitable contribution.” Such

39. S. E. C. holds this to be “misleading”; In re Thomas Bond, Inc. 5 S. E. C. 60 (1939). See also Brown Wales Co. v. Barber, 88 N. H. 103, 184 Atl. 855 (1936); and Crescent Mfg. Co. v. Hanson, 174 Wash. 193, 24 P. 2d 604 (1933).
40. See Milberg v. Baum, 25 N. Y. S. 2d 451 (1941). In this case one stockholder paid $500 for 51% of the corporation’s no-par stock, while another paid $1,700 for 49%. The trustee in bankruptcy sought to hold the first for $1,200 in “stockholders’ liability” for allegedly unpaid stock, but was denied recovery. See also Atlantic Refining Co. v. Hodgman, 13 F. 2d 781 (C. C. A. 3d 1926); Handley v. Stutz, 189 U. S. 417 (1891).
liabilities, if and when they arise, run in favor of stockholders and not creditors.

So far as promoters' liability is concerned, it is based on the doctrine that promoters occupy a trust relationship to the yet unascertained but intended shareholders. On the basis of that relationship the promoter may not profit from his dealings with the future corporation save under the white light of full disclosure to and acceptance by all the shareholders.\(^4\) Menacing as that doctrine may often have been in former times, it offers little threat to the purses or the peace of mind of promoters now, the reason being that under the Securities Act and the Securities Exchange Act, as amended, non-disclosure has been made virtually impossible in the absence of deliberate intent. In the event of such non-disclosure, however, liability is by these acts extended to include not only the original but also subsequent stockholders.

The principle of "equitable contribution" involves the right of existing stockholders not to have their equity diluted by subsequent offerings of stock at unduly low prices, which may be in reference to the book value of the stock or may also have reference to its current market price. New shares, accordingly, whether low par or no-par, must be issued at a price which under all the circumstances is "fair" to existing stockholders.\(^5\) Despite the relatively small number of cases on this facet of no-par shares, however, there need be little difficulty in most cases in predicting with some confidence the probable attitude of the courts toward particular facts. Questions of "fairness" are by no means new in the law, and actions held to be tinged with sharp practice in one situation are very likely to be looked on in the same light when the parties are associated with each other in a corporate organization.

CONCLUSION

Turning back to the battles so fiercely fought some two generations ago, their value is hard to appraise. Criticisms such as those of Bonbright may possibly have done useful service in alerting the courts to potential abuses in the issuance of no-par stock. By the same token, those same harsh criticisms may have conditioned the legislative mind to making the rigid and arbitrary tax discriminations found in the present law as an intolerable burden on no-par stock.

The simple truth seems to be that the courts have done very well indeed, on the whole, with this unfamiliar no-par stock legislation, whether viewed

\(^4\) Old Dominion Copper Mining & Smelting Company v. Bigelow, 188 Mass. 315, 74 N. E. 653 (1905).
\(^5\) Atlantic Refining Co. v. Hodgman, 13 F. 2d 781 (C. C. A. 3d 1926); Bodell v. General Gas & Electric Corporation, 15 Del. Ch. 119, 132 Atl. 442 (1926). In the later Maryland case of Ross Transport Inc. v. Crothers, 45 A. 2d 257 (1946), the sale of stock to directors was set aside at the instance of other shareholders who had not been informed as to the corporation's excellent financial condition; the grounds were breach of trust.
from the practical or the equitable standpoint. In truth, lawyers should have anticipated this from the very start, because where else in or out of government can be found another such body of men with intelligence trained to discriminate between right and wrong, and normally with the courage to follow in the path their intelligence points out? It is, accordingly, not surprising in the least that they should have encompassed the no-par statute with accepted principles of law, thus avoiding the vices feared on the one side while at the same time preserving its legitimate purposes.

It took legislation to separate the courts from a rigidly held concept about par value stock. Further legislation would be helpful also in separating them from the further fiction that corporations are created out of whole cloth in the twinkling of an eye by the mere signing of a charter, and that promotional services can or must be without reward or compensation from the corporation they bring into existence. It was the courts which took no-par statutes and made them useful and equitable in practice; it was not the courts which put no-par stock out of current use by fencing it in with discriminatory and disabling taxes. That was a legislative act and it ought to be changed.