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William W. Cook

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# MICHIGAN LAW REVIEW

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## “WATERED STOCK” — COMMISSIONS — “BLUE SKY LAWS” — STOCK WITHOUT PAR VALUE.

**S**TOCKHOLDERS' exemption from liability for corporate debts is a modern invention. It was not until 1811 that New York extended that exemption to stockholders in manufacturing corporations.<sup>1</sup> Massachusetts did not grant it until 1830.<sup>2</sup> England did not allow it to stockholders in business and manufacturing companies until 1855.<sup>3</sup> As President Eliot of Harvard has pointed out, this privilege of limited liability is “the corporation's most precious characteristic.”<sup>4</sup>

Before this limited liability was granted to private corporations for business purposes they were few in number and of little importance. Chancellor Bland, of Maryland, believed that no instance

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<sup>1</sup> L. 1811, ch. 67.

<sup>2</sup> L. 1830, ch. 53. Prior thereto, in 1809, such stockholders were declared by a Massachusetts statute to be liable for corporate debts. L. 1809, ch. 65.

<sup>3</sup> 18 AND 19 VICT., ch. 133. By 8 VICT., ch. 110, such stockholders were declared liable for all corporate debts.

<sup>4</sup> “A large part of the work of the world is still done by individuals and partnerships; but the corporation is the great new factor in modern business, the privilege of limited liability being the corporation's most precious characteristic. The principle of limited liability is by far the most effective legal invention for business purposes made in the nineteenth century—not that corporations have not other advantages over partnerships, such as the advantageous holding of real estate, the easy transference of a stockholder's interest and convenience as to suing and being sued; but the fundamental advantage of a corporation, the advantage which enables it to mass and direct capital, is the privilege of limited liability. Therefore corporations multiply and have become indispensable.”

of such a corporation in the colonial times of America could be found.<sup>5</sup> Judge Baldwin, of Connecticut, however, calls attention to the fact that the "New London Society for Trade and Commerce United" was incorporated by the colony of Connecticut in 1731, and that it not only had a capital stock, but issued circulating bills as currency. The Connecticut Land Company was organized in Connecticut in 1795 and owned the entire Connecticut "Western Reserve".<sup>6</sup> Nevertheless, during the eighteenth century, private corporations for profit were of small consequence, and it has only been during the past fifty years that the relative importance of the different classes of corporations has changed, and that private corporations for business purposes have overshadowed all other kinds. This has been due chiefly to the limited liability feature of modern business corporations.

This exemption of stockholders from personal liability for corporate debts has worked wonders in the industrial world. If such freedom from liability did not exist the public would not dare to buy stocks, because they would be liable for corporate debts. With that exemption from liability, however, the risk is reduced to the risk of the money actually paid for the stock. Hence we find in some American corporations over 100,000 stockholders—total strangers to each other, and scattered all over the world. This renders practicable those vast aggregations of capital which have revolutionized modern industry.

The ease, however, with which by reason of this exemption from liability stock can be sold to the public, has caused abuses to arise, namely, the issue and sale of "watered stock", based, not on cash

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<sup>5</sup> *McKim v. Odum*, 3 Bland, Ch. 407, 418 (Md., 1829). In the case of *McKean v. Biddle*, 181 Pa. St. 361 (1897), it appears that a mutual insurance company had not paid dividends for one hundred and thirty years, but had gradually accumulated a surplus of over \$4,000,000. The court held that it might resume the payment of dividends.

<sup>6</sup> *Holmes v. Cleveland R. R.*, 93 Fed. 100 (1861). In England trading corporations were formed much earlier. The English East India Company was organized under a royal charter granted by Queen Elizabeth, December 31st, 1600, under authority of Act of Parliament (See Burke's "Speeches in Trial of Warren Hastings", Vol. I, p. 12), with a capital of £72,000, and with 125 shareholders. The name of the company was "The Governor and Company of Merchants of London, trading into the East Indies." The Dutch East India Company was chartered March 20th, 1602, by the Netherlands states-general.

paid to the corporation equal to the par value of the stock, nor on property equal in value to the par value of the stock, but based on property transferred to the corporation at an over-valuation in exchange for the stock. Promoters are quick to see that if the property is over-valued; in other words, if a large amount of stock (the par value of which is far in excess of the actual value of the property) is issued to them in exchange for such property, and is then sold by them to the public the profits will be large. The greater the issue the greater their profit. The fact that the public does not know the real value of the property renders the manipulation easy. Later when a collapse comes, the stockholders lose their money and they don't like it; corporate creditors are not paid and they also have a grievance. Hence during the past fifty years there has arisen a great body of law as to the liability of promoters, who transfer property at an over-valuation to a corporation in exchange for stock, and then sell the stock to the public.

Naturally the old common law was silent on this subject because "watered stock" is a creature of modern times. Applying, however, old principles of common law to a new use the remedies applicable were either rescission for fraud, or an accounting for fraud, or a suit against the promoters on an implied contract on their part to pay the full par value of the stock, less the actual value of the property transferred by them to the corporation. Some courts, including the English courts, hold that rescission is the remedy.<sup>7</sup> The reason is that if the payment by property was fraudulent, then the contract is to be treated like other fraudulent contracts. It is to be adopted

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<sup>7</sup> In *Anderson's Case*, L. R. 7 Ch. D. 75 (1877), stock was issued to a promoter for property taken at an overvaluation. This action was to render him liable for the par value of the stock, less the real value of the property. The court said, pp. 94, 95, 104: "I am not going to alter men's contracts unless the provisions of an act of parliament compel me to do so. . . . But you cannot alter the contract to such an extent as to say, Though you have bargained for paid-up shares, we will change that into a bargain to take shares not paid up, and put you on the list of contributories on that ground. . . . If you set aside this allotment of shares, you must set it aside altogether, and then you cannot make the holder of them a contributory; and if you do not set it aside altogether you must adopt it, and the utmost you can do is, as I said before, that you can take away any profit from the person who has improperly made it." In *Currie's Case*, 3 DeG., J. & S. 367 (1863), the court said that the transaction "was either valid or invalid. If valid, it is clear that neither he [the person receiving the stock] nor his alienees can be

*in toto*, or rescinded *in toto* and set aside. Both parties are to be restored as nearly as possible to their original positions. The property or its value is to be returned to the person receiving the stock, and he must return the stock or its real value, if any, at the time of issue. This, of course, is not a very fruitful remedy, inasmuch as the stock turns out to have had little or no value. The Supreme Court of the United States holds that where the stock has no value when it is issued for property, the creditors are not deprived of anything and hence cannot complain. "If, when disposed of by the railroad company, it [the stock] was without value, no wrong was done to creditors".<sup>8</sup> But on the other hand that greatest of all courts has held that where the property so turned in had no substantial value, or where the overvaluation was "fraudulent", the court will hold the promoters and stockholders, who took with notice, liable for the par value of the stock, less the value of the property.<sup>9</sup>

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called upon to contribute in respect of these shares. If invalid, I cannot see my way to hold that either a court of law or a court of equity could do more than treat the purchase as void, and undo the transaction altogether. It could not, as I apprehend, be competent either to a court of law or to a court of equity to alter the terms of the purchase, and treat as shares not paid-up shares which were given as paid-up shares in part consideration of the purchase. Fraud, assuming there was fraud, would of course warrant the court in treating the purchase as void, or in undoing it; but it could not, as I conceive, authorize any court to substitute other terms."

<sup>8</sup> *Fogg v. Blair*, 139 U. S. 118 (1891), holding that where all the stock and a large quantity of bonds are issued by a railroad corporation to its contractor in payment for the construction of the road, the contractor is not liable to corporate creditors on the stock, even though the bonds without the stock were a sufficient consideration for building the road, unless the corporate creditors prove that the stock at the time of its issue has a real or market value. See also *Memphis, etc., R. R. v. Dow*, 120 U. S. 287 (1887).

<sup>9</sup> The Supreme Court in *Camden v. Stuart*, 144 U. S. 104 (1892), held liable for unpaid subscriptions the subscribers to \$150,000 of stock who had turned in therefor a *contract* for real estate and a health resort which a year prior thereto they had taken. The court did not allow any value for the contract and threw out the good will and said (p. 115): "The experience and good will of the partners which it is claimed were transferred to the corporation, are of too unsubstantial and shadowy a nature to be capable of pecuniary estimation in this connection. It is not denied that the good will of a business may be the subject of barter and sale as between the parties to it, but in a case of this kind there is no proper basis for ascertaining its value, and the claim is evidently an afterthought. The same remark may be made with regard to the contract of January 30th, and the loss of time and trouble

There is the utmost conflict and confusion in the decisions. Some courts have adopted what is called the "fair value" rule, but the trouble is that fair value before the act may not look like fair value after the act. Other courts have adopted the "good faith" rule, but the trouble here is the difficulty of fathoming the human mind, and, the courts often differ on this subject, even in the very same transaction. For instance, there are the two celebrated suits of the Old Dominion Copper Company against Lewisohn of New York and Bigelow of Massachusetts. They had sold property to the company for stock and then stock was sold to the public. The Copper Company sued Lewisohn in the federal court in New York, and the court held him not liable.<sup>10</sup> Then the Copper Company sued Bigelow in the Massachusetts state court and the court held him liable.<sup>11</sup> Judge

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to which the parties were subjected, which are now claimed to be elements of value in the property contributed to the corporation, but of which no account was made at the time." In the case *Lloyd v. Preston*, 146 U. S. 630 (1892), affirming *Preston v. Cincinnati, etc. Ry.*, 36 Fed. 54 (1888), where the owner of a railroad sold it to a newly organized corporation for stock and bonds, the par value of which was fifty times the real value of the railroad, the court held that the bondholders and other creditors who had obtained judgment against the corporation, the execution being returned unsatisfied, might hold the party receiving the stock liable thereon on the ground that the subscription price of such stock had never been paid. The court (p. 642), said: "The entire organization was grossly fraudulent from first to last, without a single honest incident or redeeming feature. It having been found, on convincing evidence, that the over-valuation of the property transferred to the railway company by Harper, in pretended payment of the subscriptions to the capital stock, was so gross and obvious as, in connection with the other facts in the case, to clearly establish a case of fraud, and to entitle *bona fide* creditors to enforce actual payment by the subscribers, it only remains to consider the effect of the defenses set up." Where \$500,000 of stock is issued for \$2 cash and a formula for cereal breakfast food, and the stock is then sold at less than par to the public, and the company fails, stockholders by statute being liable only to the extent of their unpaid subscriptions, the parties to whom the stock was originally issued may be held liable. *Wood v. Sloman*, 150 Mich. 177 (1907). Stock, which is paid for by the worthless assets of an insolvent corporation and a transfer of stock in such corporation, is not full paid and the stockholder may be held liable by corporate creditors. *Dieterle v. Ann Arbor, etc. Co.*, 143 Mich. 416 (1906).

<sup>10</sup> *Old Dominion Copper etc. Co. v. Lewisohn*, 136 Fed. 915, affirmed 148 Fed. 1020 (1905), and 210 U. S. 206 (1908).

<sup>11</sup> *Old Dominion Copper, etc. Co. v. Bigelow*, 188 Mass. 315 (1905); s. c. 225 U. S. 111:

Hough in this same litigation<sup>12</sup> well said that it has "a history writ very large in the reports, and not calculated to encourage any one who hopes to look upon the law as a science."<sup>13</sup>

The law was baffled. Meantime the evils of watered stock became so great that a demand arose for constitutional and statutory provisions against such issues. Watered stock deceived people and induced them to buy the stock or to extend credit to the company on the supposition that the capital stock had really been paid for at actual par value "in meal or in malt \* \* \* in money or in money's worth" as an English court quaintly puts it.<sup>14</sup> Hence when it became clear that the common law did not prevent such issues a demand arose for statutes and constitutional provisions to protect the public from watered stock.

This demand gave rise to certain constitutional provisions which were enacted in various states. These provisions are very similar in their wording, and are substantially as follows: "No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void." Illinois led the way in 1870, and Pennsylvania followed in 1874. Many other states have done the same. In addition many states have passed statutes on this subject.

Immediately there arose a bewildering maze of litigation construing, limiting and applying these constitutional and statutory provisions. Courts differed from courts, and even in the same state

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<sup>12</sup> 195 Fed. 637 (1911).

<sup>13</sup> Another illustration is where the Supreme Court of the United States in *Clark v. Bever*, 139 U. S. 96 (1891), refused to follow the decision in *Jackson v. Traer*, 64 Iowa 469 (1884). Both of these cases grew out of the same transaction. The Supreme Court of the United States pointed out that the State Supreme Court first decided one way, with one dissenting Judge, and then on a rehearing decided the other way, 3 to 2. Still another illustration is where the Supreme Court of Connecticut in *Conley v. Hunt*, 109 Atl. 887, stated last year that the California Supreme Court follows the "good faith" rule instead of the "fair value" rule. The Supreme Court of California did follow the "good faith" rule in *Harrison v. Armour*, 147 Pac. 1166, decided in 1915, but followed the "fair value" rule in *Zierath v. Claggett*, 188 Pac. 837, decided in 1920. In the case *Smith v. Martin*, 135 Cal. 247 (1901), the court adopted the dissenting opinion in *Smith v. Ferris, etc. Ry.*, 51 Pac. 710 (1897), where the judges divided three and three on this subject.

<sup>14</sup> *Drummond's Case*, L. R. 4 Ch. 772 (1869).

contradictory decisions filled the books. The prohibitions failed of their purpose. They did not remedy the evil which they were expected to cure. They were held to be applicable and effective only when the issue of stock was entirely fictitious. They were held not to interfere with the customary methods of starting a corporate enterprise by the issue of stock and bonds in payment for the construction of the corporate works, at a price fixed by the organizers. Practically their language and purpose have been construed away by the courts.<sup>14</sup> They lock the stable too late. Like penal statutes, they attempt to punish violation of the law after the offense has been committed. Financiers and promoters have not been deterred by these constitutional and statutory prohibitions from issuing watered stock. They have been willing to take the chances, and, of course, if a corporation prospered, the chances of attack were slight. Even where a corporation failed, the technical difficulties of enforcing these provisions, have been so great as to render them in large part nugatory. There is still the utmost confusion in ascertaining what the law really is in the application; construction, and enforcement of these provisions and of the common law. They have caused financiers and promoters to incorporate in a state, where the laws did not contain these provisions, and then such corporation carried on its business in other states. The reason of all this conflict and confusion is that courts do not like repudiation. They dislike it, not only as to municipal bonds and as to corporate notes issued in excess of a chartered limit, but also as to watered stock and so-called fictitious bonds.

Something else had to be tried. Accordingly an entirely different

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<sup>14</sup> The Supreme Court of Illinois in 1882, in the leading case *Peoria, etc. R. R. v. Thompson*, 103 Ill. 187, held that this constitutional provision was not intended to interfere with the usual business method of issuing stock and bonds. In 1884 the Supreme Court of California reached much the same conclusion in *Stein v. Howard*, 65 Cal. 616. The Supreme Court of Pennsylvania followed in 1888. *Reed's Appeal*, 122 Pa. St. 565. The Supreme Court of the United States in passing on this provision in the Arkansas constitution in the case *Memphis, etc. R. R. v. Dow*, 120 U. S. 287 (1887), held that this provision did not invalidate a transaction upon the reorganization of a company after a foreclosure of its property, and a purchase of the property by a committee for the bondholders, whereby they took in payment of such property the bonds and stock of a new corporation, even though the stock alone of the new company thus taken was, at its par value, equal to the value of the property involved.

remedy has arisen, namely, the regulation of such issues of stock before the issues are actually made. This regulation is by Public Service Commissions, "Blue-Sky Laws", and as to interstate railroads, by the Interstate Commerce Commission.

The Public Service Commissions as a rule were given jurisdiction over only quasi-public corporations, such as railroads, street railways, gas, electric light, water works, power and telegraph and telephone companies. These Commissions now exist in nearly all of the states. They have done effective work in preventing the issue of watered stock by these quasi-public corporations. They cannot remedy past issues except upon reorganization, but they can regulate future issues. They have been reasonable, conscientious and devoted to public duty in their work. Even now although they are wrong in their sturdy but losing fight to continue to control intrastate railroad rates, yet no one can fail to admire the spirit which seeks to preserve the powers of the states.

All this, however, did not remedy the greatest evil of all, namely, the issue of watered stock by private corporations. The abuses became so great, especially after the outbreak of the late war, that nearly all of the states have now enacted what are called "Blue-Sky Laws", appointing Commissions to pass upon proposed issues of stock before such stock is sold. They are called "Blue-Sky Laws" because they stop the sale of stock that represents nothing but blue sky—nothing terrestrial or tangible. The lower courts in many instances held these laws to be unconstitutional, but the Supreme Court finally upheld their constitutionality.<sup>15</sup> Massachusetts here led the way in 1875<sup>16</sup> in providing that a State Commissioner of Corpora-

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<sup>15</sup> Hall v. Geiger-Jones Co., 242 U. S. 539 (1917); Caldwell v. Sioux Falls, etc. Co., 242 U. S. 559 (1917); Merrick v. Halsey & Co., 242 U. S. 568 (1917).

<sup>16</sup> That statute was enacted in 1875 (MASS. LAWS, 1875, Ch. 177, p. 769), Section 2 being as follows:

"Conveyance of property, real or personal, at a fair valuation, to the corporation, shall be deemed a sufficient paying in of the capital stock, to the extent of such value; provided, that a statement, made, signed and sworn to by the president, treasurer and a majority of the directors of the corporation, giving a description of such property, and the value at which it has been taken in payment, in such detail as the commissioner of corporations shall require or approve, and endorsed with the certificate of said commissioner, that *he is satisfied that said valuation is fair and reasonable*, shall be filed with the secretary of the Commonwealth; and provided, further, that if said property be not so conveyed and taken at a fair valua-

tions pass upon the issues of stock by manufacturing and other corporations before such issues were made. That state did not wait until the stock had been issued and sold. It applied the remedy in the origin of the transaction, and that remedy of commission regulation has been found to be effective as well as just. There are few Massachusetts decisions on watered stock—a proof of the justice and efficacy of the Massachusetts remedy, which has since been adopted by many other states under the name of “Blue-Sky Laws”, but not yet in New York—the chief promoting center.

Properly administered these “Blue-Sky Laws” will check many of the swindling operations, which otherwise would be perpetrated upon the public. And there is much need, just now. During the late war excessive profits were made by nearly all classes. The usual and natural method of transferring these profits from incompetent hands into hands competent to invest and conserve the same, was speculation. This process, however, has been largely displaced by the sale of worthless, fraudulent stocks. “Blue-Sky Laws” are intended to prevent this and are based on the right principle.

A third application of the Commission idea appears in “The Transportation Act” of Congress of 1920. That Act requires the approval of the Interstate Commerce Commission to the issue of stocks or bonds by interstate railroad corporations before such issues are made.<sup>17</sup> It will prevent a repetition of some of the ruinous and scandalous financing of railroads in the past. It is true that if this provision had existed sixty years ago, the present railroad systems would not have been built, because the speculative chance of making large profits by the issue of watered stock and bonds built the railroads. But the time has come for a change.

We now come to the most peculiar remedy of all, namely, the issue of stock without any par value whatsoever. This can hardly

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tion, the officers of the corporation signing such statement shall be jointly and severally liable for its debts and contracts.” This statute that the commissioner of corporations must pass upon the value of property, which is turned in for stock, cannot be evaded by the parties paying cash to the corporation for the stock and then using that cash to buy the property from themselves. Yet if they do so under advice of counsel, they are not liable for the penalty for doing so. *Harvey-Watts Co. v. Worcester, etc. Co.*, 193 Mass. 138 (1906).

<sup>17</sup> Act of Congress of February 28, 1920, adding Section 20a, to the INTERSTATE COMMERCE ACT.

be called a remedy. It is quite the reverse. It legalizes instead of restricting large issues of stock for property. The theory of this recent innovation is that the American public should be educated up to the idea that a share of stock represents but a proportion of the corporate property.<sup>18</sup> The American public, however, is incurably imbued with the idea that a share of stock represents or should represent a fixed sum, instead of the imagination or machinations of promoters. As a matter of fact, the public generally has no definite idea of the value of property turned in for stock, and hence if unlimited stock may be issued for all kinds of property the danger of fraud is greatly increased. Unreliable men may issue stock without par value to an amount limited only by their capacity to induce the public to buy it. It is of course safer for promoters to issue stock without par value for choice assortments of property,<sup>19</sup> but how the investor and the public benefit has not as yet appeared. Stock without par value adds to the mystery as to what the stock really repre-

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<sup>18</sup> The original New York statute on the subject, enacted in 1912, was amended in 1920 (L. 1920, Ch. 608, p. 1550), and the amendment contains the following:

"Such corporation may issue and may sell its authorized shares, from time to time, for such consideration as may be prescribed in the certificate of incorporation, or 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 for such consideration as shall be consented to by the holders of two-thirds of each class of shares then outstanding at a meeting called for that purpose in such manner as shall be prescribed by the by-laws. Any and all shares as permitted by this section shall be deemed fully paid and non-assessable and the holder of such shares shall not be liable to the corporation or to its creditors in respect thereof."

The Act by its terms does not apply to moneyed corporations or corporations subject to the state Public Service Commission.

<sup>19</sup> The Corporation Company of Delaware in one of its circulars, relative to the Delaware statute of March 20, 1917, authorizing the issue of stock without par value, said:

"Stock without par value can be issued full paid in any desired amount for contracts, patents, mines, oil leases, services and similar considerations whose real value generally cannot be accurately estimated. The operation is merely an exchange of property for shares without any dollar mark of value being placed upon the property or the shares and it is not open to question. It insures future stockholders absolutely against liability based on overvaluation of assets.

"Stock without par value can be issued full paid by a corporation at any

sents, and the public still compares the market price of such stock with \$100 par, without regard to whether or not the stock is without par value. Even the courts in construing these new statutes, do so in that frame of mind.<sup>20</sup> In fact under the New York statutes some par value had to be recognized and so the certificate of incor-

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price, or for any consideration that will meet the requirements from time to time,—thus as the actual value of the stock varies, the price at which it is issued can vary and no circuitry, evasion of the law or fictitious valuation is necessary.”

In the hearings before the Joint Interstate Commerce Committees of the Senate and House at Washington in regard to railroads, on December 2nd, 1916, Senator Cummins said (p. 399) in regard to the suggestion of the railroads that they incorporate under federal charters and issue stock without par value, “I recognize that it is a method. That simply deludes the country, that is all. It avoids realization of the fact that the value of the property is less than the capitalization.”

<sup>20</sup> A foreign corporation with shares having no nominal or par value may be allowed to do business in Kansas. *North American, etc. Co. v. Hopkins*, 181 Pac. 625 (Kan., 1919), involving a Delaware corporation, the court saying that the license fee paid to the state could be ascertained by ascertaining what property was represented by such stock. A foreign corporation having stock of no par value may be required, in qualifying to do business in the state, to pay a license fee based upon a value of \$100 per share. *Detroit, etc. Corp. v. Vaughan*, 178 N. W. 697 (Mich., 1920), 19 MICH. L. REV. 95. This last case also involved a Delaware corporation, and the court pointed out that the Delaware statute provided that as to franchise taxes such stock without par value was to be taken as of the par value of \$100 each. A foreign corporation having stock without par value is entitled to a certificate from the Secretary of State of Missouri to do business in that state, even though the Missouri statutes do not provide for such stock. *State v. Sullivan*, 221 S. W. 728 (Mo., 1920). Here also a Delaware corporation was involved, and the same provision in the Delaware statutes was pointed out. In this Missouri case the court intimated (p. 737) that the holders of shares without par value might be liable to corporate creditors for the difference between the fixed value of their shares and the amount paid for them, “just as they would be if the shares had a par value”, but it is difficult to understand this statement.

By the Act of Congress approved April 5, 1918, known as the “War Finance Corporation Act”, § 203, shares of stock without par value are to be considered as of the par value of \$100 each. See Acts of Congress, 1917-1918, p. 513. The Federal Revenue Act of 1918 provides that on the issue of stock without face value a stamp for 5c per share should be attached, the same as though it had a par value of \$100, unless the actual value is more, in which case the stamps shall be more. See Act of Congress of February 24, 1919, § 1107 (3), and there is a further tax of 2c per share on a transfer of any share without par value unless it is worth more than \$100 (4). The New

poration, if stock without par value is issued, must state such stock at \$5 per share<sup>21</sup>—certainly low enough—almost a mining proposition.

The latest suggestion is that railroads might sell new issues of stock at less than par value, if such stock be issued without par value. This, however, would discredit the old issues. Those old issues, representing cash at par, will sooner or later be protected by the public, but if they are watered by the issue of new stock without par value, the public will take an entirely different view of the matter. It would be like an issue of depreciated currency. For illustration, the Pennsylvania Railroad has issued its stock in the past at par, and sometimes more than par; for instance at 110 in 1913, and at 120 in 1903. The present market price is about 70. If new stock were now issued at 70 or less, the holders of the old stock would lose the protection which public opinion throws, or will throw, around actual investments in railroads.<sup>22</sup>

The case is a little different with a private corporation, such as a manufacturing or business corporation, where the government does not regulate rates or prices, and hence the above objection as to railroad stock may not apply. As to these manufacturing or business corporations if new capital is necessary and the outstanding stock sells at less than par it is argued that new stock without par value may well be issued and sold at about the market price and thus fresh money obtained. Such a power, however, vested in the directors would lead to abuses and, moreover, in most cases financing could be done more easily and conservatively by issuing preferred stock. In some instances in England as many as five classes of pre-

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York statutes are practically the same. STOCK CORPORATION LAW, § 21 (L. 1917, Ch. 501), and as to a sale of stock see TAX LAW, § 270 (L. 1913, Ch. 779).

<sup>21</sup>Laws of 1920, Ch. 608, p. 1550, requiring the capital to be the preferred stock, if any, plus "a sum equivalent to five dollars for every share authorized to be issued other than such preferred stock." The previous statute of 1912 (L. 1912, Ch. 351), read five dollars or "some multiple of five dollars."

<sup>22</sup>I do not believe that stock without par value would help the railroads. "The Transportation Act" of 1920 does help them but not enough. My views on that subject were expressed in the pamphlet I issued in December, 1920, entitled, "Will the Railroad Act of 1920 Solve the Railroad Problem?" Copies of that pamphlet will be furnished free on application.

ferred stock have been issued from time to time, to meet the financial necessities and possibilities of the company.<sup>23</sup>

It has been stated that this scheme of stock without par value is a German device. That is a mistake. The early New England turnpike charters did not contain any par value of the stock, nor, in fact, did they specify the capital stock itself.<sup>24</sup> The stock was without par value; and was paid for in cash and not by property. It was without limited liability and could be assessed indefinitely, but the holder could stop paying and forfeit his stock, unless he had expressly agreed to pay. The stock was like the present "stock without par value", except that it was issued for cash and with liability, instead of for property and no liability. On the whole stock without par value looks like a skillfully devised scheme for issuing a maximum of watered stock at a minimum risk. In the hands of reliable men it may be all right, but not needed; in the hands of unreliable men it is all wrong. It conceals the mystery of the "water". The old turnpike shareholders were neighbors and each knew the value of the turnpike, but the modern buyer of stock has only a glimmering, and even that is now taken away with no compensating advantages. Investigators will grow wary of stock which dares not state on its face how much money or property it represents. The old law, even with its feeble liabilities, had some restraining influence on the cupidity of promoters; this law has none. While investors do not object to liberal profits to promoters, yet they do object to unfair profits in the way of too many shares to pay reasonable dividends. Investors do not know, and have no means of knowing what a promoter pays for the property he capitalizes. Shares without par value conceal what money or property a share really represents.

The English way is better. In a blue book published by the English Government in June, 1907, the Comptroller of the Company's Department made the following statement in regard to the Acts of Parliament on the subject of corporations:

"The trend of recent legislation in this country has been to

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<sup>23</sup> See *Corry v. Londonderry, etc. Ry.*, 29 Beav. 263 (1860).

<sup>24</sup> *Middlesex Turnpike Co. v. Swan*, 10 Mass. 384 (1813). The charter of the Worcester Turnpike Corporation, Laws of Massachusetts, 1806, Ch. 67, p. 15, is a good illustration of those early charters. No capital stock is specified and no par value of shares is specified.

endeavor to afford information concerning joint stock companies to all who may seek for it, on the ground that *publicity is the best protection* which can be devised for the benefit of creditors and of investors, and that, moreover, it is fair to demand publicity of companies and to compel disclosure of material facts by them in return for the privilege of limited liability. With regard to the protection of creditors and investors it has been truly said that legislation cannot protect people from the consequences of their own imprudence, recklessness or want of experience. Nor can the Legislature supply them with prudence, judgment, or business habits. It can, however, make it possible for the creditor or investor to obtain the information necessary to enable him to form a judgment."

How have the English dealt with this whole subject? England is the source and natural home of the promoter. The British Empire extends throughout the world, and finds itself compelled, like the Roman Republic, to absorb new countries for the preservation of what it already has—a process which will require the co-operation of all branches of the Anglo-Saxon race. Each new territory acquired opens new enterprises, the capital for which is raised in London. Hence there has developed in England a system of organizing companies to operate in distant lands. This system was, and is, carried on by financiers, promoters, prospectuses and offerings of stock to the public. Abuses crept in. Frauds were perpetrated on the public, by the promoters purchasing property at a low price and then selling it to a newly organized company at a high price, in exchange for stock, and then selling that stock to the public. Later when the enterprise dwindled or collapsed, and when recourse was had to the courts, it was found that the legal remedies availed little. The money was gone. On account of the many frauds perpetrated upon the public by the issue of stock for property taken at a gross over-valuation, Parliament, in 1867, passed an act requiring all contracts whereby stock was issued for property or services to be publicly registered, under penalty of the payment being void.<sup>25</sup> In 1908 Parliament en-

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<sup>25</sup> 30 and 31 Vict., Ch. 131, § 25. "Every share in any company shall be deemed and taken to have been issued and to be held subject to the payment of the whole amount thereof in cash, unless the same shall have been other-

acted a new statute on this whole subject. The issue of shares is strictly regulated.<sup>26</sup> Particularly are prospectuses, which are issued to sell the shares, regulated by this Act of Parliament.<sup>27</sup> Lord Chancellor Halsbury summarizes the remedies of a shareholder for fraud in these respects, as follows :

- "1. Defence of misrepresentation to an action for calls.
- "2. Rectification of the register of members and consequent relief.
- "3. Rescission of the contract.
- "4. Damages in an action of deceit.
- "5. Damages under the statutory provisions replacing the Directors Liability Act, 1890.
- "6. Criminal proceedings."<sup>28</sup>

This certainly looks like a formidable list of remedies, but an English court, as late as 1904, said :

"I hope the day may come when it will be gravely considered by the Legislature whether it is not for the advantage of the community, and in particular of the commercial community, that an Act should be passed that in all cases the full nominal value of a share shall be paid in cash and nothing else. I am satisfied from my own judicial experience in the administration of companies that such a law would have a tendency to benefit the companies themselves, and also to check a great deal of unwholesome speculation on the Stock Exchange which is largely fed and supported by operations undertaken by vendors, promoters, and others, for the purpose of unloading fully paid shares which they have been allowed to satisfy by giving what is called money's worth instead of making a cash payment."<sup>29</sup>

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wise determined by a contract duly made, in writing, and filed with the registrar of joint-stock companies at or before the issue of such shares."

<sup>26</sup> See LAWS OF ENGLAND, by Halsbury, Lord High Chancellor, Vol. V, pp. 87-92 (1910).

<sup>27</sup> See HALSBURY, pp. 120-142.

<sup>28</sup> See HALSBURY, pp. 127-142.

<sup>29</sup> *Moseley v. Koffyfontein Mines, Ltd.*, [1904], 2 Ch. 108.

This proposed reversal to the old time method of issuing stock for cash only will not be adopted, but the above quotation shows how the English are troubled with this same problem. Neither is it at all likely that England will adopt the American plan of Commissions, approving such issues of stock for property before such issues are sold to the public, because London promotions cover enterprises all over the world, and a London Commission could not possibly pass intelligently on the value of foreign concessions, prospects, properties and values. In America this phase of the problem does not face us, our corporations being at present confined almost exclusively to domestic enterprises, but as America broadens and spreads abroad in its investments, foreign enterprises will be capitalized in America and the stock sold. Then, too, American Commissions will find it difficult to pass on the actual value of foreign concessions, prospects, properties and values. Furthermore, there is danger in Commissions approving issues of stock, in that the approval of a Commission is an official approval, and if mistakes are made, as made they surely will be, the public will buy the stocks relying on such approval.

It will be seen that the whole subject is still in the melting pot. So far the speculative proclivities of the Anglo-Saxon race have outmaneuvered the law.

WILLIAM W. COOK.

*New York, N. Y.*