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CORPORATIONS—WATERED STOCK—REJECTION OF STATUTORY OBLIGATION THEORY—Plaintiff, a judgment creditor of a corporation in which defendant was a stockholder, sued for the difference between the aggregate par value of the defendant's shares and the value of the consideration he paid to the corporation for them.[1] After a verdict for plaintiff, the trial court granted a motion for a new trial. On appeal, *held,* affirmed. Liability of shareholders for watered stock is based on the misrepresenta-

[1] Defendant was issued 4500 shares by the corporation. He turned over to the corporation assets totaling $34,780.00, i.e., sufficient consideration for only 3478 shares having a par value of $10. Pursuant to a directive of the Commissioner of Corporations, at the time the shares were issued 1022 shares of the 4500 were therefore placed in escrow and were subjected to certain limitations on their transfer. The California Supreme Court held, however, that "the defendant acquired sufficient title to the 1022 shares to permit the plaintiff to proceed against him for their par value." Principal case at 8.

tion theory in California, and there was no evidence that plaintiff relied on the stated capital in extending credit. *Bing Crosby Minute Maid Corp. v. Eaton,* (Cal. 1956) 297 P. (2d) 5.

The finding as to the plaintiff's reliance is not open to serious question and would be proper grounds for disposition of the case were it not for a statutory provision in California seemingly designed to impose liability on shareholders to pay par value for stock without regard to creditor reliance.[2] The court construed this provision as not creating any right in favor of creditors, however, and argued that it is merely declaratory of the common law misrepresentation theory, and further, that had the legislature intended to create such a right, it would have explicitly said so. A subsequent section of the same statute,[3] however, clearly indicates that the legislature intended to allow creditors to maintain actions to reach shareholders' liability, and it does not seem incongruous that statutory rights and obligations would be found in separate sections of the code. Such deficits in payment for capital stock have been held to constitute assets of the corporation available to creditors,[4] and this view would seem to render unnecessary explicit statutory language creating a right in favor of creditors. The statutory obligation theory which the court here rejected as a basis for imposing liability would render the holder of the stock responsible to creditors whether or not there had been reliance on the overvaluation of the capital. The leading case for this theory is *Easton National Bank v. American Brick and Tile Co.*[5] in which the court said that stockholders' liability rests on their voluntary acceptance of a statutory scheme to which watered stock is absolutely alien. In spite of the fact that most legal writers consider the statutory obligation doctrine to be the most logical basis for imposing liability for watered stock,[6] and the fact that a great many states have some kind of constitutional or statutory provision stipulating the consideration which must be received for stock having par value,[7] most jurisdictions have construed statutory provisions of the type in question

2 Cal. Corp. Code Ann. (Deering, 1953) §1110. "The value of the consideration to be received by a corporation for the issue of shares having par value shall be at least equal to the par value thereof. . . ." (This provision is subject to three exceptions, none of which is applicable to the situation in the principal case.)

3 Cal. Corp. Code Ann. (Deering, 1953) §1306. This section allows an action to be brought on behalf of a creditor to reach the liability of a shareholder to pay the amount due on his shares, but not before the creditor has proceeded to judgment against the corporation, which judgment is unsatisfied after an attempt to levy on corporate assets, or can establish that such proceedings would be useless. It further allows for intervention by all the creditors of the corporation in any such action, the rendering of several judgments, and the crediting of payments made by shareholders on the unpaid balance due the corporation on their shares.

4 Union Saving Bank v. Leiter, 145 Cal. 686, 79 P. 441 (1905).

5 70 N.J. Eq. 732, 64 A. 917 (1906).

6 See, e.g., BALLANTINE, CORPORATIONS, rev. ed., §351 (1946).

7 Bonbright, "Shareholders' Defenses Against Liability to Creditors on Watered Stock," 25 COL. L. REV. 408 (1925).

as declaratory of the common law fraud theory.[8] California's acceptance in the principal case of this view might be explained by the fact that the statutory obligation theory would not be applicable had defendant been issued no par stock, which would have been permissible.[9] When stock of this character is issued, liability is limited to the consideration agreed to be paid for the shares.[10] It would seem that the concept of no par stock has made the general concept of liability for watered stock somewhat tenuous. The decision in the principal case is consistent with a general tendency evidenced by the courts to limit the situations in which the shareholder will be held liable.[11] Minimizing the distinction between par and no par stock should not be accomplished by eliminating the distinction between legislative and judicial functions. If provisions requiring that par value be paid for par stock have lost their purpose, then it is for the legislature to remove them, and not for the judiciary in effect to ignore them by construing them as merely declarative of the common law fraud theory.

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[8] See, e.g., Collier v. Edwards, 144 Okla. 69, 289 P. 260 (1930).

[9] Cal. Corp. Code Ann. (Deering, 1953) §1100. "Stock corporations may issue [classes of shares] without par value. . . ."

[10] Cal. Corp. Code Ann. (Deering, 1953) §1300. "Every subscriber to shares and every person to whom shares are originally issued is liable to the corporation for the full consideration agreed to be paid for the shares."

[11] E.g., the tendency of the courts to cut off recovery by creditors against stockholders who have paid all they agreed to pay. See GLENN, FRAUDULENT CONVEYANCES, rev. ed., §608 (1940).