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By Frederick H. Hurdman

For many years it has been recognized by the business world that there were evils inherent in the custom of issuing capital stock with an arbitrary dollar value on each certificate. For this reason such prominent attorneys as Francis Lynde Stetson, Louis Marshall, Victor Morawetz and the late Edward M. Shepard, of the New York bar, advocated the proposition of authorizing corporations to issue stock without par value.

Mr. Shepard, in an address which he made before the Illinois Bar Association in 1907, among many other arguments advanced by him in favor of this form of capital stock, said that it would have a tendency to direct attention to real instead of fictitious values; that it would check inflation of assets in order that sufficient debits might appear on the statements of corporations to offset the nominal value arbitrarily placed upon the certificates of stock issued; and that the unsuspecting investor would not be misled into thinking that because the symbol $100 appeared on a certificate of stock it must have a real value at or near that amount. Furthermore, he could not find any real advantage in assigning a nominal or fictitious value to the certificate.

His definition of "overcapitalization" was not that a company had too much capital, but the very contrary. The distinction is well made between "capital" and "capitalization." It is the excess of nominal capital over real capital which is the offense.

The modern corporation is nothing more nor less than a restricted form of partnership. Such differences as exist lie in the fact that the corporation may have a life not dependent upon its membership; the members may transfer their rights and liabilities; and there is a limit of liability for debts.

According to Mr. Shepard the origin of the legal requirement that the articles or certificate of incorporation shall state a company's capitalization seems to have been in the original identity between nominal capitalization and actual capital or net assets.

When the English crown issued or the English parliament authorized corporate charters, there was a jealousy of the money

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power of the corporation. A charter frequently, as in the time of Queen Elizabeth, gave or sought to give a monopoly of some kind to a corporation. The power of the corporation was dreaded. It was at least a matter of privilege or favor. It was, therefore, to be limited to such and such an amount of wealth. In our time, and certainly for our country, this purpose has been practically lost. We have the Standard Oil Company of New Jersey capitalized at $100,000,000 with actual capital five times that amount.

In January, 1892, a report was made to the New York State Bar Association by a committee consisting of Francis Lynde Stetson, D. S. Remsen and Robert T. Turner, suggesting a law for a distinct class of business corporations whereby they might issue their capital stock without money denomination, merely representing proportional shares in that enterprise.

The general mining laws of Prussia enacted in 1865 provided for companies without denomination of shares.

Louis Marshall gave as his opinion recently:

> Eventually it will not only become a part of the jurisprudence of most of the states of the union, but in twenty years from now few corporations will be organized on any other principle.
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> I believe it to be the only reasonable method of representing stock ownership in a corporation. The old method of placing an arbitrary dollar mark on a certificate of incorporation led to stock-watering, the creation of false values, and proved to be an easy medium for carrying out fraudulent schemes and practices. Under the new system every share of stock represents an aliquot interest in the corporate assets. Its value is dependent upon the actual value of the assets, and not upon any fictitious or imaginary value. That is the honest way of issuing stock. In the past a corporation which acquired undeveloped mining property issued shares of stock by the thousands and arbitrarily fixed the value of the shares at amounts which varied from $1 to $100 each. Those corporations had capital stock to the amount of $1,000,000 or $100,000,000, which had merely a potential value; but speculation was carried on with the idea that the par value had some relation to actual value. It is unnecessary for me to say that such practices are inimical to the public interest. It has now become the usual thing for corporations which are honestly managed to issue their stock without par value. The experiment has proven most satisfactory, and bankers who at first were skeptical are now found to favor the issuance of stock on this new and reasonable theory.

Furthermore, the commendation of the railroad securities commission, whose report was transmitted to congress in 1911, brought the proposition prominently before the entire country. The New York State Bar Association early prepared an amendment to the New York corporation law which was finally enacted in 1912. In that report the commissioners said:

We do not believe that the retention of the hundred dollar mark, or any other dollar mark, upon the face of the share of stock is of essential importance. We are ready to recommend that the law should encourage the creation of companies whose shares have no par value and permit existing companies to change their stock into shares without par value whenever their convenience requires it. After such conversion any new shares could be sold at such price as was deemed desirable by the board of directors, with the requirement of publicity as to the proceeds of the sale of such shares and as to the disposition thereof; giving to the old shareholders, except in some cases of reorganization or consolidation, prior rights to subscribe pro rata, if they so desired, in proportion to the amount of their holdings.

As between the two alternatives of permitting the issue of stock below par or authorizing the creation of shares without par value, the latter seems to this commission the preferable one. It is true that it will be less easy to introduce than the other because it is less in accord with existing business habits and usages; but it has the cardinal merit of accuracy. It makes no claims that the share thus issued is anything more than a participation certificate.

The objections to the creation of shares without par value are two in number: first, that their issue will permit inflation, by making it easy to create an excessive number of shares; and, second, that it will produce a division of roads into two classes, those whose shares have a par value and those whose shares have not. The second of these objections does not appear to be a very serious one. There are listed on the stock exchanges today, side by side with one another, shares of the par value of one hundred dollars, shares of the par value of fifty dollars, shares with very much smaller par value, and a few, like the Great Northern Ore certificates, with no par value at all. The share sells in each case simply for what the public supposes it to be worth as a share. The danger of inflation deserves more serious consideration. We believe, however, that it is more apparent than real, because shareholders will be jealous of permitting other shareholders to acquire shares in the association except at full market value, and will not permit the issue of such shares to themselves at prices so low as seriously to impair the market or other value of their holdings. Shares either with or without par value, and whether sold at par or above par or below it, should, except in cases of consolidation and reorganization, be offered in the first instance to existing shareholders pro rata.

The issue of stock without par value offers special facilities for consolidation and reorganization.

Where two roads have consolidated, whose shares have different market values, it has been the custom to equalize the difference by the issue of extra shares of the consolidated company to the owners of the higher priced stock. This practice has always tended to produce increase of capital issues, and may readily cause the new stock to be issued for a consideration less than its par value. The only alternative was to scale down some of the old stocks; and this often involved serious difficulties, both of business policy and of law. By the simple expedient of omitting the dollar mark from the new shares, the number can be adjusted to the demands of financial convenience, without danger of misrepresentation or suspicion of unfairness to anyone.

In the case of reorganization, the advantage of shares without par value is even more obvious. It is here that the necessity and justice of getting money from stockholders is greatest. It is here that the impossibility of getting them to pay par for new shares is most conspicuous. We believe that in such cases the public interest would be subserved and the speedy rehabilitation of the roads promoted by requiring the conversion of the common stock and encouraging the conversion of the pre-

ferred stock into shares without par value; the certificates simply indicating the proportionate or preferential claims of the holders upon assets and upon such profits as might from time to time be earned.

All of these considerations seem to apply with equal force to the securities of railroads under state incorporations, and we believe the laws of the several states could with advantage be modified so as to provide for the issuance of stock without par value.

Since the original bill, which was passed by the legislature of the state of New York in 1912, nine other states have enacted laws providing for the issuance of stock of nominal or no par value, so that today we find these statutes in California, Delaware, Illinois, Ohio, Pennsylvania, Maine, Maryland, New Hampshire, New York and Virginia.

A study of the laws of these various states discloses the desirability of a movement for uniformity in corporate legislation. In the table (on pages 254 and 255) there is presented a brief synopsis of the important elements entering into these laws. This is not meant to be authoritative, as in many instances the entire act should be considered in order to understand fully the limitations set down.

The New York state law contemplates a corporation whose creditors are advised at the formation of the company that the actual paid-in capital of the company is at least a given amount. The capital stock without par value may be issued at any value within the methods provided, subject only to the requirement that the actual paid-in capital shall equal in amount the stated capital before the corporation shall begin to carry on business or shall incur any debts.

The corporation 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.

A peculiar feature of the Virginia law is that it provides that "the maximum amount of the authorized capital stock of the corporation shall be stated in dollars in the application for a charter." As the number of shares must also be stated it would appear that a nominal value is thus established.

It is interesting to note that in the New York law, and that of other states modeled after it, not only is there an attempt to provide that creditors shall have due notice of the minimum capital invested before the privilege of doing business is granted to the corporation, but the law has further restricted the reduction of the actual capital of the business to an amount less than the stated capital stock unless it be determined by the proper authorities that the reduced amount of capital is sufficient for the purpose of the business and is in excess of the ascertained debts and liabilities. The statute of Ohio, however, provides that preferred stock may not be redeemed, purchased or retired if thereby the property and assets of the corporation will be reduced below the amount of the outstanding liabilities, but in providing for the reduction of common stock the law states that the reduced amount of capital must be in excess of its debts and liabilities.

Whether the framers of the law really meant, in both cases, that the assets should still exceed the liabilities or whether it was the intention in reducing capital to leave $2 of assets for every $1 of liabilities is not clear; but at any rate in the New York law and that of several other states it is specifically stated that the capital remaining shall be in excess of the debts and liabilities. It will be noted that the word "capital" in the statute is used exclusively in the sense of stockholders' equity.

It is further provided by the laws of most of the states that no dividend shall be declared which will reduce the amount of the capital below the stated capital, and the directors are made liable to the corporation or to its creditors for any dividend paid in violation of this principle. The Ohio law, in addition to forbidding the dividend which will reduce the capital below the amount of stated capital, also provides that dividends shall not be paid from any fund received from the sale or disposition of its capital stock.

The New York law in referring to methods of taxation provides that the rate of dividend shall be computed by dividing the total amount of dividends which had been paid during the year by the amount of the net assets of the corporation on the first day of the year. This departure from the custom of considering the dividend as being based on originally paid-in capital

is, of course, in line with the whole theory of the no-par-value stock, that one share of stock represents one aliquot part of the excess value of assets over liabilities.

A brief summary of the results achieved in the issuance of stock without par value, as provided for in the New York law, follows:

1—Working capital may be provided without the necessity of inflating the book value of assets.

2—Stock may be issued for its real value without reference to any nominal value.

3—Stockholders are assured that stock issued is "fully paid-up."

4—Potential creditors are notified of the minimum capital actually paid in and are protected against any depletion of the capital of the company below such amount.

5—The credit of the corporation is based upon sounder and more substantial valuation of assets and in consequence will probably receive greater confidence on the part of investors and creditors than would be accorded to the same corporation without such assurance.

Though these advantages seem clearly to inhere in the case of corporations organized under this statute, it would, however, seem that the statute does not forbid the depletion of the actual capital, whether invested or earned, except when such depletion will reduce the capital below that stated in the certificate of incorporation or subsequent notice of addition or deduction. In other words, in so far as the New York statute is concerned it would appear that dividends may be paid out of capital if that capital exceeds the amount of stated capital. The law of Ohio specifically forbids the payment of dividends from any fund received from the sale or disposition of capital stock, and Pennsylvania and Delaware forbid the payment of dividends out of capital or out of anything except net profits or surplus earnings.

A study of the various statutes demonstrates that Pennsylvania is the only state which authorizes the issuance of stock preferred as to principal without par value, but several other states appear to authorize the issuance of stock preferred as to dividends, the New York statute being worded to authorize the

issuance of shares of stock of such corporation other than preferred stock having preference as to principal without any nominal or par value.

California and Maine have similar provision, but Delaware and Maryland specifically except stock preferred as to dividends as well as stock preferred as to distributive shares of assets or subject to redemption at a fixed price. The Ohio law provides only for the issuance of common stock without par value and further provides that preferred stock with par value shall not, in number, be more than two-thirds of the total number of all shares. Illinois does not specify exceptions.

A rather interesting decision has just been handed down by the supreme court of Kansas in the case of the North American Petroleum Company, a Delaware corporation, organized under the no-par-value statute of that state, which sought to do business in the state of Kansas, which does not have a no-par-value statute. The state authorities attempted to exclude this company on the ground that it was not such a corporation as is contemplated by the laws of Kansas. The court in its findings advanced the following in support of its contention that the company should be admitted to do business:

> The problem of determining the solvency and bona fide capitalization of the plaintiff presents no unusual difficulty. The fact that the shares of its stock have no nominal par value is of little consequence. Any prudent charter board, in determining whether a foreign corporation is worthy of admission to do business in Kansas, would attach little importance to the nominal value of its shares of stock, even if they have a nominal value. As in all other cases, the charter board should concern itself earnestly to ascertain the genuine capital—those assets permanently devoted to the corporate business as a basis for its business credit, and upon which the hope of profit is rationally founded.
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> The "lawfully issued capital" and the "capital stock" of such corporations are the assets that it devotes to the prosecution of its business. When the value of these assets is ascertained, the fee, required to be paid by law, can be based on that portion of the assets which the corporation proposes to "invest and use in the exercise and enjoyment of its corporate privileges within this state."
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> The defendants contend that the plaintiff is not such an organization as is called a corporation in the constitution and laws of this state. The answer to this contention is that corporations without capital stock and without shares of stock are not new; they are as old as corporations themselves, and have existed in England and in this country for many years; our constitution recognizes them, and we have laws for their control and government.

In recording stock of no par value on the books and setting up values in the statements of assets and liabilities, it does not

seem that any difficulties are presented. The capital account should reflect the value at which the stock was issued—whether for cash, property or services. The only other account representing a measure of value in the outstanding stock, outside of certain reserve accounts, would be the surplus account. In my opinion this account should at all times represent undistributed net earnings of the corporation.

Inasmuch as the capital account will not generally reflect on its face the number of shares outstanding it will be necessary to show in the capital account itself the shares issued. It does not become necessary, as in the case of stock with par value, to carry any portion of the proceeds received from its sale to a paid-in-surplus account. Furthermore, the fact that stock may be issued at varying values for each share has no significance other than to raise or lower the unit or share value for every other share outstanding. Each share represents an aliquot part of the entire capital, other than that portion which may be allocated to one class of stock by virtue of preference.

The number of shares authorized should be noted on the capital stock account. A separate account is, of course, unnecessary to record this fact.

It is probable that very few cases will arise involving donated treasury stock, as that is one of the evil practices this form of legislation was designed to prevent. No reasonable object would be attained by issuing stock of no par value at a nominal value and then donating a portion of that issued stock back into the treasury, presumably for sale to provide working capital. The incorporators would undoubtedly retain the required number of shares for this purpose at the time of incorporation. In the event of such a contingency arising, however, I would suggest that the number of donated shares be carried in treasury stock account without any money value. The number of shares indicated by this account would then be deducted from the issued shares shown in the capital account, in order to show on the statement the actual number of shares outstanding in the hands of the public, which is the essential fact.

When stock of this description is purchased by the company and placed in the treasury, it should be recorded in treasury stock account at its purchase price and shown on the statement

SYNOPSIS OF ESSENTIAL FEATURES

State	Year enacted	Corporations excluded	Amount of capital necessary to commence business
New York	1912	Moneyed corporation or corporations under jurisdiction of any public service commission.	Minimum $500 Par value of authorized preferred and $5 or some multiple thereof for each share of no par value stock authorized to be issued
Maryland	1916	Moneyed or safe deposit corporation	No provision
California	1917	None	Par value if any of preferred and $1 or some multiple thereof of all other shares authorized — preferred and common
Delaware	1917	None	No provision
Maine	1917	Banking, insurance or corporations under jurisdiction of public utilities commission	Minimum $1,000 Preferred $5 or some multiple thereof but not more than $100 and $5 or some multiple thereof for each share no par value stock
Virginia	1918	Moneyed corporation	No definite provision except minimum as fixed in certificate of incorporation
Illinois	1919	Banking, insurance, real estate, brokerage, the operation of railroads or the business of lending money	At least one-half value of stock with par value and not less than $5 per share for stock no par value, but not less than a total aggregate of $1,000
Pennsylvania	1919	Building and loan, banking and insurance companies	Number of shares with and without par value, and amount of capital to begin business
New Hampshire	1919	Banking, insurance or railroads	No provision
Ohio	1919	Same as New York	Same as New York

IN VARIOUS NO-PAR-VALUE STATUTES

Consideration for issuance	Basis of taxation	Classes of stock which may be issued without par value
Consideration prescribed in certificate of incorporation or fair market value, in judgment of board of directors or such consideration as consented to by two-thirds of each class of shares outstanding	Organization tax 5 cents for each share authorized, 12 cents for each share on sales or transfers	Other than preferred stock having a preference as to principal
Consideration to be fixed by board of directors but if stock already outstanding confirmation by two-thirds of holders of each class is necessary	Presumed to be of the par value of $100 for bonus and franchise tax	Other than stock preferred as to dividends which is subject to redemption or stock preferred as to its distributive share of the assets of the corporation
Consideration prescribed in articles of incorporation	Amount stated in certificate of incorporation, each share an aliquot part of entire capital subject to the amount or par value of preferred shares	Other than preferred stock having a preference as to principal
Any amount stated in certificate of incorporation or determined upon by board of directors	Presumed to be of the par value of $100	Other than stock preferred as to dividends or preferred as to its distributive share of assets or subject to redemption at a fixed price
As provided in certificate of incorporation or as fixed by board of directors if authorized in such certificate. If certificate of incorporation does not authorize directors, then by consent of two-thirds of holders of each class of stock	Presumed to be of the par value of $100	Other than preferred stock having a preference as to principal
As determined by corporation and according to statement filed with and approved by state corporation commission		Other than preferred stock
As provided in certificate of incorporation or as determined by the board of directors, not less than $5 per share	Presumed to be of the par value of $100	Class of stock not specified. Each certificate shall have stamped thereon when issued, the amount actually received by corporation for such stock, either in cash, property, services rendered or expenses incurred
Consideration prescribed in certificate of incorporation, by stockholders or by directors acting under authority of stockholders	Presumed to be of the par value of $100	Preferred stock of any or all classes or common stock of any class or both preferred and common stock, preference to be named in certificate. Preference rights, limitations and restrictions may be stated in dollars and cents per share
Consideration prescribed in certificate of incorporation or authorized by two-thirds vote of stock outstanding	Presumed to be of the par value of $50	Common or preferred
At time of opening books of subscription for such consideration as may be decided upon by incorporators and thereafter fair market value or as agreed to by a majority of the outstanding common stockholders		Shares of common stock

as a deduction from capital account at the amount paid therefor. The number of treasury shares would also be deducted from the total shares outstanding.

In presenting the capital account in the corporation statements the important thing is to show the number of shares issued and outstanding, with the value of these shares as reflected by the books or the statements in question.

In examining the published reports of certain companies issuing stock with no par value it was noted in a few instances that an attempt was made to show the amount of capital issued against various properties included in the assets of the corporation. This practice would not have been followed in the case of stock issued, say, with par value of $100, and I can see no good reason for stating it in that manner where the stock issued has no nominal or par value. As each share of stock without par value represents an equal portion of the capital, there cannot be any great advantage in setting up the capital account in this way.

The fact that certain states provide in their statutes for a stated capital does not mean that such stated capital must be set out separately on the books of the corporation or its published statements. It does signify, however, that the directors may not incur debts until such stated capital is paid in. It may be good practice, however, to indicate by a note or indention on the balance-sheet the amount of the stated capital, but no good reason exists for separating the actual capital paid in into two or more divisions.

The following arrangement for the balance-sheet is suggested:

Capital (declared $600,000)		
7% cumulative convertible preferred stock, 5,000 shares of $100 each	$500,000.00	
Balance represented by 9,875 shares of common stock without par value	764,210.87	
Total paid-in capital	$1,264,210.87	
Earned surplus	1,362,984.75	
Total capital		$2,627,195.62

It would appear that an unusual opportunity presents itself to us to familiarize ourselves with the advantages and workings of this law, with a view to recommending whenever possible, in the formation of new enterprises, that stock be issued without par value. Anything that tends to get nearer the facts should appeal to the imagination of and be encouraged by the accountant.