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## CORPORATIONS - CAPITAL, CAPITAL STOCK AND STOCK

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CORPORATIONS — CAPITAL, CAPITAL STOCK AND STOCK — The recent case of *Haggard v. Lexington Utilities Co.*<sup>1</sup> is typical of the nominalistic confusion occasioned by the use of the terms "capital" and "capital stock." Whatever progress the courts have made toward making them words of precise signification has not been reflected in the drafting of statutes, where they are employed to represent a bewildering number of connotations. The courts have recognized this and have not sought to make them words of art with a single, definitive meaning but through the mechanics of statutory interpretation have sought to divine the legislative intent.

No criticism can be made of such an attitude. The legislature meant that its language should have a certain meaning and the only function of the court is to discover what it is and apply it to a given situation. However, it is highly desirable that in performing such a task the court indicate that whatever meaning is assigned in the particular instance is only because of the exigencies of the individual situation and the evident intent in employing the particular form of language.

Historically, the terms "capital," "stock," and "capital stock" were probably imported into the law from the vocabulary of economics and commerce.<sup>2</sup> The economists of the late eighteenth and nineteenth centuries thought of capital as that portion of economic goods dedicated to the production of future goods as contrasted with those goods destined for more or less immediate consumption.<sup>3</sup>

Too great violence was not done to economic concepts of this

<sup>1</sup> 260 Ky. 261, 84 S. W. (2d) 84 (1935). The statute in question [Ky. Stat. (Carroll, 1930), § 553] provided that any corporation might increase or decrease its capital stock by a vote or by the written consent of "stockholders representing two-thirds of its capital stock." Section 559 gave a corporation the right to change or amend any of the articles of its incorporation by the consent in writing of at least two-thirds of the capital stock. These provisions are automatically a part of every Kentucky corporation charter. Less than two-thirds of the preferred stock was voted for the proposed amendment, but it did receive the votes of more than two-thirds the total shares outstanding. The court says, at p. 266: "The December amendment was adopted by the vote of stock representing more than two-thirds of the money paid in by the stockholders, and this conformed to the requirements of section 553 of the Statutes."

<sup>2</sup> See Dwight, "Capital and Capital Stock," 16 YALE L. J. 161 (1907).

<sup>3</sup> See, for instance, SMITH, THE WEALTH OF NATIONS, Book II, c. I (1796).

sort when, with the growth and increasing complexity of corporate structures, capital came to signify the more permanent fund of assets of the corporation.<sup>4</sup> In the ordinary situation, this corresponded very closely with the amount derived from the original sale of shares, particularly under the customary accounting practice of carrying assets at cost.

The precise modern meaning of "stock," once used to signify a body of assets, becomes apparent when contrasted with the hybrid "capital stock." This latter has been employed in the most varied senses.

"Capital stock" has been used in statutes to signify the property holdings of the corporation.<sup>5</sup> By the same token, "capital" and "capital stock" have been conceived to be roughly synonymous and interchangeable.<sup>6</sup> It has even been considered to denote the stock the rights of which are junior to all others; that is, the common stock.<sup>7</sup>

What is the proper and simplest rationale by which to resolve this confusion in nomenclature? The concepts which the better considered cases seek to tag by the various terms would seem relatively simple, although it is with surprising infrequency that they are expressed clearly and unequivocally.

A corporation has, it is possessed of, a "capital." It is the "estate" of the corporation in its property; in other words, all that is represented on the right side of the balance sheet over and above its indebtedness—the corporation's equity in its assets.<sup>8</sup> In a going business, therefore, it is by definition a perpetually fluctuating amount; it is the exact antithesis of the fixed sum it has sometimes been defined as being.

<sup>4</sup> See Dwight, "Capital and Capital Stock," 16 *YALE L. J.* 161 (1907).

<sup>5</sup> *Kohl v. Lilienthal*, 81 Cal. 378, 20 P. 401, 22 P. 689 (1889); *Central Illinois Public Service Co. v. Swartz*, 284 Ill. 108, 119 N. E. 990 (1918); *Cristensen v. Eno*, 106 N. Y. 97, 12 N. E. 648 (1887). Cases, not all entirely relevant, are collected in 11 *FLETCHER, CYCLOPEDIA CORPORATIONS*, perm. ed., 10 (1931). A construction of this sort is very commonly arrived at in the consideration of taxation statutes. *Henderson Bridge Co. v. Commonwealth*, 99 Ky. 623, 31 S. W. 486 (1895), *affd.* 166 U. S. 150, 17 S. Ct. 532 (1897); *Hecht v. Malley*, 265 U. S. 144, 44 S. Ct. 462 (1924). See generally, 14 *FLETCHER, CYCLOPEDIA CORPORATIONS*, perm. ed., c. 60 (1931).

<sup>6</sup> 11 *FLETCHER, CYCLOPEDIA CORPORATIONS*, perm. ed., 10 (1931), marshals the jurisdictions which have at one time or another adhered to such a view.

<sup>7</sup> *Citizens' Loan & Savings Co. v. Arwood*, 17 Ala. App. 76, 81 So. 854 (1919).

<sup>8</sup> *Christensen v. Eno*, 106 N. Y. 97, 12 N. E. 648 (1887); *Smith v. Dana*, 77 Conn. 543, 60 A. 117 (1905); *State v. Cheraw & C. Ry.*, 16 S. C. 524 (1881); *Tradesman Pub. Co. v. Knoxville Car Wheel Co.*, 95 Tenn. 634, 32 S. W. 1097 (1895); *Person v. Board*, 184 N. C. 499, 115 S. E. 336 (1922). The language of the cases often indicates that the courts have in mind, when they employ "capital" in this sense, not only the corporation's equity in its assets but the entire corporate property without regard to indebtedness.

The corporation's equity in its assets is, of course, often broken down by accounting and legal practice into capital stock as used in the usual balance sheet sense — par value or the amount realized from the sale of shares — surplus, various "reserves," and undivided profits.<sup>9</sup> It may be taken to signify only part of the equity embraced by the generalized definition attempted. However, for the purposes of the present comparison, this modification may be passed by with a caveat.

Having used "capital" in such a broad sense, "capital stock" acquires a much less ambiguous and omnibus meaning. When courts view capital stock as something pertaining to, in the sense of belonging to, the corporation, they must, if the expression is to be more than a synonym, refer to the assets or part of them. Apparently, notions of this sort were at one time entertained, for an old Massachusetts case<sup>10</sup> speaks of "shares in the capital stock" rather than "shares of the capital stock" as they are now universally spoken of. The emphasis has now shifted and the capital stock is no longer thought of as something of value owned by the corporation.<sup>11</sup>

It would not be unreasonable to use "capital stock" to designate the shares in the hands of their holders; and this has been done.<sup>12</sup> However, we have another term which may be used to represent this conception. Stated in dollars and cents, "capital stock" is measured by the sum of the aggregate par value of the par value shares subscribed plus that amount contributed, or at least promised to be contributed, to the corporation upon the taking of subscriptions for the shares without par value.<sup>13</sup> Confusion might be avoided, then, simply by defining "capital stock" as an amount equal to the par value of all par value stock outstanding plus the actual consideration received for whatever shares without par value the corporation may have issued.<sup>14</sup>

The amount of "capital stock" is therefore determined by the original transaction between the corporation and the subscribers and is

<sup>9</sup> *Public Service Comm. v. Consolidated Gas, etc. Co. of Baltimore*, 148 Md. 90, 129 A. 22 (1925); *Owensboro Nat. Bank v. City of Owensboro*, 173 U. S. 664, 19 S. Ct. 537 (1899); *Malley v. Old Colony Trust Co.*, (C. C. A. 1st, 1924) 299 F. 523; *In re Prudential Trust Co.*, 244 Mass. 64, 138 N. E. 702 (1923).

<sup>10</sup> *Fisher v. Essex Bank*, 5 Gray (71 Mass.) 373 at 374 (1855).

<sup>11</sup> If a corporation is permitted to carry its own stock as an asset, it is as "treasury stock," which is something quite different. See Dwight, "Capital and Capital Stock," 16 *YALE L. J.* 161 at 165-166 (1907).

<sup>12</sup> *Peters Trust Co. v. Douglas County*, 106 Neb. 877, 184 N. W. 812 (1921).

<sup>13</sup> *Chicago, M., St. P. & P. R. R. v. Harmon*, 89 Mont. 1, 295 P. 762 (1931); *Farrington v. Tennessee*, 95 U. S. 679 (1878); *State v. Cheraw & C. Ry.*, 16 S. C. 524 (1881); 11 *FLETCHER, CYCLOPEDIA CORPORATIONS*, perm. ed., 12 ff. (1931).

<sup>14</sup> *Christensen v. Eno*, 106 N. Y. 97, 12 N. E. 648 (1887); *State v. Cheraw & C. Ry.*, 16 S. C. 524 (1881).

not in constant fluctuation due to the varying fortunes of the business.<sup>15</sup> If the stock all has a par value, the amount of "capital stock" may properly be spoken of as an "invariable sum" which may be altered only by a formal act of the corporation, following a statutory scheme.<sup>16</sup>

"Stock," under such an analysis, is the other side of the same picture. It is the "capital stock" as viewed distributively in the hands of the shareholders.<sup>17</sup> The value of the total stock, however, will be equivalent in amount to the capital stock only if the business remains absolutely static. In a going business, the actual value of each share of stock will be its ratable proportion of the corporation's net assets.

Briefly then: a corporation, upon organization, enters into a contractual proprietary relation with subscribers who contribute money, services, or goods which (assuming as to par value shares the contribution is the equivalent of the par value) measures the corporation's "capital stock" and for which in return they receive "stock." From this the newly born corporation acquires a "capital" which, assuming the shares issued are paid up, is identical in amount with its "capital stock." Immediately the venture is launched, however, the corporation has an equity of ownership in a certain body or "estate" of goods, its assets, which, depending upon the fortune or lack of it attending the adventure, will be greater or less than the fixed and static amount defined as "capital stock." This variable estate is "capital."

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<sup>15</sup> *Williams v. Western Union Tel. Co.*, 93 N. Y. 162 (1883); *State v. Morristown Fire Assn.*, 23 N. J. L. 195 (1851); *Tradesman Pub. Co. v. Knoxville Car Wheel Co.*, 95 Tenn. 634, 32 S. W. 1097 (1895); *Person v. Board of State Tax Comms.*, 184 N. C. 499, 115 S. E. 336 (1922); *Farrington v. Tennessee*, 95 U. S. 679 (1878).

<sup>16</sup> This may or may not be true of no par value stock. See *Roberts & Schaefer Co. v. Emmerson*, 313 Ill. 137, 144 N. E. 818 (1925).

<sup>17</sup> See Dwight, "Capital and Capital Stock," 16 *YALE L. J.* 161 at 165 (1907).