CORPORATE MATTERS:
THE VALUE OF PAR VALUE

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PAR VALUE

The majority of our corporate engagements begin with a request from a foreign client, or professional representing their client, to form a U.S. entity through which to engage in some activity in the United States. Depending on the nature of the activity and the client involved, we typically recommend the formation of either a Delaware C-corporation or limited liability company. If the entity is to be used as a holding company, a relatively simple corporate structure is required. In the case of a C-corporation, which is the focus of this article, a limited number of a single class of stock, few directors and basic officer appointments is usually the way the corporation is established.

When we send the incorporation documents to our client for signing, the certificate of incorporation includes the following clause, or a variation thereof:

> The total number of shares of stock which the corporation is authorized to issue is Two Hundred shares of common stock, par value $0.01 per share.

Typically, the initial capital of the corporation is considerably more than 200 times (or what ever the number of shares initially authorized is) the par value and we often receive inquiries from non-U.S. colleagues and clients as to what the par value is and why it is out of step with the capital initially paid in to the company. We thought it might be helpful to provide a brief description of par value as it relates to the common stock of a U.S. corporation.

WHAT IS PAR VALUE?

The par value of a stock is the value per share set forth in the certificate of incorporation filed with the secretary of state. Also called nominal or face value, the par value is the minimum price per share that must be paid in order for the shares to be considered fully paid and has no bearing on the fair market value of the stock. The par value also appears on the company's stock certificate. One is less likely to be aware of this now as larger, particularly public, corporations move to electronic certification and more closely held private corporations are uncertified – meaning they do not necessarily issue a stock certificate as evidence of ownership.

The only real significance of par value has to do with liability shareholders may have if stock is sold below the par value.

If shareholders pay less than the par value for a share of stock and the issuing company later becomes unable to meet its financial obligations, its creditors can sue shareholders for the difference between the purchase price and the par value

to recoup the unpaid debt. If the market price of the stock falls below the par value, the company may be liable to shareholders for the difference. For example, if company XYZ issues 10,000 shares of stock with a par value of $25, then the minimum amount of equity that should be generated by the sale of those shares is $250,000. Since the market value of the stock has virtually nothing to do with par value, investors may buy the stock on the open market for considerably less than $25. If all 10,000 shares are purchased below par, say for $15, the company will generate only $150,000 in equity. If the business goes under and cannot meet its financial obligations, shareholders could be held liable for the $10-per-share difference between par and the purchase price.

"The par value of stock is not to be confused with the par value of a bond."

Most companies opt to set a minimum par value for their stock shares to circumvent either of these scenarios – Amazon stock has a par value of $0.01, for example.

Historically, companies were required to state a par value for the their stock – most states, Delaware among them, now allow for no par value stock. The "no par" status means that the company has not assigned a minimum value to its stock. No par value stocks do not carry the theoretical liabilities of par value issues since there is no baseline value per share. However, since companies assign minimal par values if they must, there's little effective difference between a par stock and a no-par stock.

DIVIDENDS

The par value of a stock is also factored in when determing whether a surplus exists for the purpose of declaring and paying dividends.

Sections 170 and 173 of the Delaware General Corporation Law (the "Delaware G.C.L.") prohibit a Delaware corporation from declaring or paying a dividend except out of "surplus." "Surplus" is defined in section 154 of the Delaware G.C.L. as, "the excess, if any, at any given time, of the net assets of the corporation over the amount…determined to be capital."

Under Section 154 of the Delaware G.C.L., "capital" is determined for par value stock as being the par value of the consideration received for the stock and for stock with no par value, the entire consideration received for the issuance of such stock constitutes capital unless the board allocates a smaller portion of the total consideration to capital. "Net assets" is the amount by which total assets exceed total liabilities.

To determine whether a surplus exists, a valuation of the corporation's net assets is required. The value of the net assets of a corporation reflected on its books (based on generally accepted accounting principles) may not, however, reflect the current market value of the corporation's assets and liabilities. Delaware courts have recognized this conflict and have permitted the directors of a corporation to "revalue" the assets and liabilities of the corporation when determining whether a surplus exists.

BOND PAR VALUE

The par value of stock is not to be confused with the par value of a bond. Bonds are fixed-income securities issued by corporations and government bodies to raise capital. The par value of a bond is quite different to the par value of a stock. Unlike a stock, a bond has a real par value. A bond with a par value of $1,000 really can

be redeemed for $1,000 at maturity. To the average investor, the par value of a bond is quite relevant, while the par value of a stock has become something of an anachronism.

ACCOUNTING CONSIDERATIONS

In most cases, the par value of the stock today is little more than an accounting concern, and a relatively minor one at that.

The only financial effect of a no par value issuance is that any equity funding generated by the sale of no par value stock is credited to the common stock account. Conversely, funds from the sale of par value stock are divided between the common stock account and the paid in capital account. When stock is issued at a price higher than its par value, the cash account is debited with the total amount of cash received, the capital stock account is credited with the total par value of shares issued and an account known as additional paid-in capital or capital in excess of par is credited with the difference between cash received and the par value of shares issued.

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