

# SHARES IN THE EMCA: THE TIME IS RIPE FOR TRUE NO PAR VALUE SHARES IN THE EU, AND THE 2<sup>ND</sup> DIRECTIVE IS NOT AN OBSTACLE

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## Abstract

*The most interesting proposal in the draft European Model Companies Act (EMCA) concerning shares and the focus of this Article is the recommendation to introduce true no par value shares, as they have been in use in the US for many years and were introduced in Australia, New Zealand but also Finland more recently. Contrary to what has often been assumed, the 2nd EU Company Law Directive does not preclude no par value shares. There is nothing in the wording of the Directive to suggest otherwise, and the reference in the Directive to shares without a nominal value is a reference to Belgian law, which has allowed true no par value shares in all but name since at least 1913. EU member states could therefore introduce such shares even for public companies. True no par value shares offer a far more flexible framework in case of capital increases or mergers, but since under a no par value system there is no link between par value and shareholder rights, additional disclosure about these rights might be warranted under a no par value system. Traditional par value shares offer no protection to creditors, shareholders or other stakeholders, so that their abolition should not be mourned. The threat of new share issues at an unacceptably high discount is more efficiently countered by disclosure and shareholder decision rights.*

## Introduction

The European Model Companies Act (EMCA)<sup>1</sup> that is discussed in this special issue of *ECFR* tries to deal with the regulation of shares in a comprehensive way, as detailed as a regular national Companies Act would. However, by far the most interesting and innovative proposal contained in the EMCA's Chapter 5, dealing with shares, is the suggestion to allow companies to adopt true no par value shares. These are shares that do not represent a fraction of the company's legal capital, neither from a legal nor from an accounting perspective. The rights attached to these shares, such as voting and profit rights, are consequently not determined by the fraction of legal capital they represent nor by a formally fixed nominal or "par" value, but simply by the articles of incorporation or the issuing conditions. The price paid for such shares in the form of a contribution is freely determined by the issuing company and the subscribers to the shares, and the contributions paid for such shares may be booked either as capital or as a reserve ("surplus", as American lawyers often call it), at the discretion of the company. Under such a system, historical par values/accountable pars, i.e. the value of contributions paid for shares that have been issued earlier in the history of the company, play no role when new shares are issued. Such a "true no par value" system has been in use in

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<sup>1</sup> For the September 2015 draft of EMCA, which is the latest version that is public, see the website of the department of business law of Aarhus University <http://law.au.dk/en/research/projects/european-model-company-act-emca/>. For some background, see Theodor Baums and Paul Krüger Andersen: The European Model Company Act Project. ECGI - Law Working Paper No. 97/2008, available at [ssrn.com/abstract=1115737](https://ssrn.com/abstract=1115737), as well as a French version: Theodor Baums, "Lois modèles européennes en droit des sociétés", *Revue des Sociétés* 2008, pp. 81–88. See also the brief comments by Marco Ventoruzzo at <https://corpgov.law.harvard.edu/2015/10/14/the-new-european-model-company-act/>.

many US states following the example set by New York in 1912 and was introduced in Finland in 2006. Belgium has had a system that is very close to a true no par value system since at least 1913.

In this article we will explain the true no par value system and argue that it is more user friendly than the traditional system based on nominal value or fixed accountable par shares. At the same time doing away with the old system would not hurt the interests of any stakeholders. The traditional system has never protected the company's creditors, and the protection it could offer shareholders is not only limited, but especially inefficient: it stands no chance of surviving a cost-benefit analysis which would show that other methods that hinder companies far less, protect shareholder rights at least as well. We will also try to convince readers that a true no par value system is perfectly compatible with the 2nd EU Company Law Directive<sup>2</sup>, and can therefore be introduced by member states in public companies, too, without any amendments to this Directive. Indeed, we will argue that especially after the amendments to many national companies acts in the Eurozone in the wake of the introduction of the euro, several such member states have in fact abandoned what little substantive protection the old rules on par value offered. Many member states make life unnecessarily difficult for companies by forcing them to jump through several procedural hoops when performing a capital increase, while at the same time these procedural rules do not protect existing or future shareholders or creditors in any meaningful way.

Before we discuss this main theme of this article, we will first briefly sketch the EMCA's philosophy concerning the regulation of shares and illustrate this with a few examples of specific rules that the EMCA recommends as good practice to national legislators.

## **I. The general approach to shares in the EMCA**

Some of the main questions facing anyone regulating shares are:

- To what extent should companies be free to determine the rights attached to the shares and should multiple voting rights be allowed ? Should shareholder rights be proportionate to the percentage of legal capital a share represents? This latter question only makes sense in an environment where at least corporations (limited liability companies) have legal capital and where shares have a par value, which is still an important concept in Europe. What, in this context, is the exact meaning of the concept of "class" of shares and how should one deal with changes to class rights – what, indeed, exactly is a change to class rights?
- Should shares have a par value or are true no par value shares along the Finnish and US model allowed?
- What forms can shares take: is it a good idea to still allow bearer shares or should all shares be registered in someone's name ? Shall one allow paper share certificates or even make them mandatory? What about book-entry shares ("dematerialized", "electronic" shares)
- Are there reasons to limit the possibility of articles of association or perhaps also shareholder agreements to limit the free transferability of shares? Should there be

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<sup>2</sup> For the recast of the original 1976 Directive, as amended mainly in 2006, see Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 54 of the Treaty on the Functioning of the European Union, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent, *OJ L 315*, 14.11.2012, p. 74–97.

mandatory statutory limitations to the free transfer of shares in private companies/ companies that legally are considered “close(d) companies” ?

- What is the value of the share register? Is it indicative of who is the owner of the shares? Or is it simply a means of making transfers of shares reliable against the company and third parties? Who should be allowed to consult the share register? Shareholders? The public in general? Public authorities?
- Redeemable shares: certain countries allow either the company or the shareholder ( in certain company types) to redeem shares in the sense that the shares will be annulled and their value will be paid out; is it wise policy to provide for redeemable shares and under what circumstances?

It would not be very interesting to summarize here the answers the EMCA has given to all of these questions. I will limit myself to a few general remarks in this section, before the main body of the text then extensively deals with the issue of true no par value shares.

As indicated in the introduction to chapter 5 of the EMCA, the drafters of the EMCA take the view that national legislators should not introduce a *numerus clausus* for the types of shares and debt instruments that companies can issue: companies should be free to create types of shares or other securities not explicitly mentioned in companies acts or other legislation. More generally, the EMCA takes as its starting point and default position contractual freedom, i.e. the freedom for the articles of incorporation (and sometimes the issuing conditions of financial instruments) to deal with issues, including types of shares. Only when there are clear potential negative externalities, or when transaction costs could be substantially reduced, should legislators intervene through mandatory rules (and therefore the EMCA Group debated, among other things, whether bearer shares should still be allowed since they can be used to render certain fraudulent organisations more opaque; or whether shares with multiple voting rights should be allowed since they lead to a disconnect between power and financial investment and risk which could stimulate certain beneficiaries of the system to disregard the negative financial consequences for most shareholders of corporate actions that increase the power of the holder of shares with more than 1 vote).

Another illustration of the philosophy that freedom of contract should prevail is that the issue of free transferability of shares should, according to the drafters of the EMCA, be left largely to the articles and shareholder agreements. In private companies, there is no need for statutory limitations on the free transferability of shares, but shareholders should be allowed to introduce such restrictions<sup>3</sup>. In public companies too, restrictions should be allowed, but of course a very far-reaching limitation of free transferability in the articles could under certain national companies acts lead to the conclusion that the company is not a public company at all.<sup>4</sup>

A second guiding principle of the EMCA is that companies acts should only deal with the corporate law aspects of legal issues, and should not try to decide civil law issues, e.g. contract or tort law questions, or issues related to the law of estates<sup>5</sup>. This approach is

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<sup>3</sup> See generally s. 13 of Chapter 5 EMCA.

<sup>4</sup> In addition, for listed companies restrictions on free transferability would often be outlawed by listing rules or securities regulation. The EMCA does not deal with these.

<sup>5</sup> For the EMCA as a model law intended to be an inspiration for lawmakers all over the world, it would have been even more presumptuous than for the drafters of national companies acts to try and come up with “the best solution” concerning civil law questions, such as e.g. the interference between a shareholder agreement that

illustrated in section 11( 6) of EMCA chapter 5, concerning the share register. This provision makes clear that the person mentioned as shareholder in the share register is entitled to exercise the rights attached to the shares registered in its name, and recommends to adopt a rebuttable presumption that the persons mentioned in the share register are the owners of the shares. But how this presumption can be rebutted and how more generally legal ownership of shares is acquired and can be transferred, is largely left to general common law (contract law, law on moveable property, ..).

There is one issue on which the drafters of the EMCA have taken a stance which is probably not bold enough. The EMCA does not contain a recommendation to abolish bearer shares. There is an international trend towards more transparency about share ownership also in private companies and bearer shares are of course less transparent than registered shares. The current European and world-wide debate about shareholder identification and particularly about identifying the ultimate owner/beneficiary of shares has to be seen against the background of an increased desire to combat tax evasion, corruption, money-laundering and financial fraud. In June 2013 G8 leaders agreed on a set of principles on beneficial ownership transparency. These were followed by FATF –Financial Action Task Force, the international anti-money-laundering standards body- “Guidance on Transparency and beneficial ownership (October 2014) and the “High level Principles on beneficial Ownership” adopted by the G20 in November 2014. More concrete and specific action was undertaken by the UK with its March 27 2015 ”Small Business, Enterprise and Employment Act 2015” which organizes a public register listing the beneficial owners also of private companies (as well as requiring that company directors are natural persons). Denmark has announced plans for similar legislation and the 4<sup>th</sup> EU Anti Money Laundering Directive, adopted the obligation for all EU member states to organize a register where all corporate entities will have to file information about beneficial ownership<sup>6</sup>. For the same reasons, there has been worldwide pressure on the use of bearer shares, and some member states have either, like Belgium, completely outlawed the use of bearer shares, or limited their use to public companies (where free transferability of shares is important and which, outside a system of book-entry shares, is easier with bearer than with registered shares). The EMCA does not deal with administrative, regulatory rules that impact companies but are not part of organizational law and therefore contains no rules on ownership transparency. The Group considered advocating a ban on bearer shares along the Belgian model, but in the end refrained from doing so because in several countries a deep attachment to bearer shares exists at least for certain company types. It remains to be seen whether this will survive the international regulatory tide. At the time of drafting the EMCA, the Group thought a balance could be struck between the desire for more transparency while still allowing bearer shares by a system of mandatory disclosure of large (more than 3 or 5%) shareholdings, as it has been organized for listed companies by the EU Transparency Directive. Such a system could be expanded to non-listed, including private companies, even though enforcement could turn out to be difficult.

## **II. Towards the adoption of true no par value shares: the strange world of the existing par value systems**

### **1. The concept of par value and the differences and similarities between shares with nominal value and those without nominal value or with an “accountable par”**

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limits the free transferability of shares and rules from the law of successions that mandate universal succession to the heirs upon the death of a shareholder.

<sup>6</sup> See art. 30 of directive (EU) 2015/849 of May 20 2015.

The truly innovative rule in the EMCA concerning shares is the proposed possibility for companies, including public companies, to use true no par value shares<sup>7</sup>. This is indeed one of the most important suggestions made in the EMCA as a whole.

Every companies act needs to tackle the issue of how to determine the rights attached to shares. One obvious possibility is to leave this to the articles and/or issuing conditions, so that parties<sup>8</sup> can agree to whatever they want. This approach is taken in the American Model Business Corporation Act (MBCA) and more generally in the US as a whole. This contractual freedom can be limited by legislators that nevertheless take this approach as their starting point, typically by provisions that either outlaw multiple voting rights shares or limit the multiplier for such shares, and by provisions protecting shareholders against subsequent changes to the rights attached to their shares or against transactions that, while not formally changing the rights attached to the shares, would negatively impact the power or the financial benefits attached to the shares (“dilution”).

But shares traditionally also represent a part of legal capital<sup>9</sup> and a second way of determining the rights attached to shares is to state that these rights will be proportional to the fraction of the legal capital that a share represents. This is the default approach taken by many European countries, among others France<sup>10</sup>, Germany, Poland and Belgium<sup>11</sup>. Legal systems that choose this route can then still differ in the extent to which they allow departures from this principle, or on the contrary make it wholly mandatory<sup>12</sup>.

The “fraction of the legal capital that a share represents” is called its *par value*. This is a purely formal value that has nothing to do with the market value of the share, its fundamental value<sup>13</sup> or its book value<sup>14</sup>, except in one extremely limited sense, namely that traditionally shares may not be issued for consideration less than their par value.

Traditionally, most European companies acts required- most still do- to express this par value through a number, called *nominal value*<sup>15</sup>. Under systems that mandate companies to use

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<sup>7</sup> See section 5 Chapter 5 EMCA, and the general introduction to Chapter 5.

<sup>8</sup> The people setting up the company; or the company issuing the shares and the person subscribing to these newly issued shares.

<sup>9</sup> At least in companies that enjoy limited liability and need to have a legal capital.

<sup>10</sup> E.g. art. L 225-122, see also e.g. P. Le Cannu and B. Dondero, *Droit des sociétés*, Paris, Montchrestien, ed. 2009, p. 738, nr. 1123.

<sup>11</sup> Even in the UK this is the default rule, but it is clear that it is easier to deviate from the rule in the UK than in Germany, France or Belgium, among others. For a description of the UK approach, see e.g. *Mayson, French and Ryan on Company Law*, Oxford, 31st ed. 2014-15, p. 160-161.

<sup>12</sup> For instance, In Belgium voting rights in both public (NV/SA) and private (BVBA/sprl) corporations are mandatorily proportional to the nominal value or accountable par of the share (art. 541 Belgian Companies Code, for public companies), whereas for profit rights such proportionality is only mandatory in private corporations (art. 238 Belgian Companies Code, stating the principle that in a private company all shares must have the same rights, except for non-voting preference shares).

<sup>13</sup> In the sense of the value the market should attach to the share if it valued the share according to the principles of a pricing valuation method as developed in financial economics (e.g. discounted cash flow method, multiples method, etc.).

<sup>14</sup> “Simple” or “uncorrected” book value is synonymous with net asset value, meaning net assets (assets minus debt and provisions) of the company divided by number of shares. This is of course exactly the same as dividing equity broadly defined by number of shares, in still other words adding legal capital plus share premiums plus retained earnings/reserves and some more exotic equity components that may figure in the balance sheet and dividing the sum by number of shares issued.

<sup>15</sup> In many countries, companies acts used to contain minimum amounts of nominal value per share, below which shares could not be issued. Most but by no means all countries have by now abolished this requirement, or have

nominal value shares, “nominal value” and “par value” are synonyms<sup>16</sup>. Nominal value times number of shares then gives the amount of stated legal capital in the company. For instance, if a company has issued 1 million shares with a nominal value of 10, its share capital will be 10 million (and conversely, if one reads in the accounts or articles that a company has a legal capital of 10 million and has issued 1 million shares and operates with shares with a nominal value, one can deduce that this nominal value must be 10 (unless the legal system under which the company operates allows one company to issue shares with different nominal values).

Shares may not be issued under their par value (“no discount” rule)<sup>17</sup>. This rule is sometimes criticized as obsolete or unnecessary, but it is not and the criticism is misguided. One may criticize the concept of par value –indeed this article will- but if a legal system uses par value and especially if this par value is expressed as a nominal value, it is necessary to provide that shares may not be issued under their par value. The rule is self-evident and a normal consequence of double-entry bookkeeping. A nominal value system necessarily implies that when new shares are issued, the liability side of the balance sheet will show an increase in legal capital equivalent to the number of shares times their nominal value. If the contribution for such shares were lower than their nominal value, there would be a mismatch between assets and liabilities because the company would have received fewer assets than indicated by the increase of legal capital. This would violate accounting rules, would be misleading to creditors and would most of the time simply constitute fraud. The opposite situation, where a share premium is demanded above the par (nominal) value, and therefore only a part of the contribution is booked as legal capital, is not problematic as such.

What is problematic is not the rule that shares in a par value system may not be issued below their par value, but other rules and practices usually found in such systems, namely that shares either by law or for practical purposes must all have the same nominal value, so that nominal value is fixed in time; that new shares can therefore not be issued at a price lower than the par value of the already existing (“old”) shares; and that companies who want to work around these rules for perfectly legitimate purposes –the most frequent situation being that they want to issue new shares at a realistically low price, reflecting the fact that book and market value of the existing shares are below their par value- must jump through all kinds of tiresome procedural hoops.

Before we can discuss this issue fully, it must be pointed out that it is, however, feasible to express par value in another way than through a nominal value. Instead of using a number like

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set the minimum at such a low level (e.g. 0.001 dollar or euro) that it has lost all practical meaning. The amount need not be a whole number but may be a fraction in most countries. Germany is an important exception: par values there must be at least 1 euro and may not be fractions of whole numbers ( § 8 (2) AktG). But even in this most conservative of legal capital countries, minimum par value has been lowered to the low amount of one euro.

<sup>16</sup> See E. Ferran, *Principles of Corporate Finance Law*, Oxford, 2008, p.86 and L. Gullifer and J. Payne, *Corporate Finance Law*, Oxford and Portland, 2<sup>nd</sup> ed. 2015, p. 153, who expressly indicate this is the case under English law. The nominal/par value requirement under UK law can be found in s. 542 Companies Act 2006.

<sup>17</sup> M. Lutter, *Kapital, Sicherung der Kapitalaufbringung und Kapitalerhaltung in den Aktien- und GmbH-Rechten der EWG*, Karlsruhe, 1964, 159 points out, with an impressively rich list of references to national company legislation and doctrine, that the rule that at the moment the company was set up no issues below par were allowed, had been known in all founding members of what is now the EU long before the 2<sup>nd</sup> Company Law directive harmonised the rule. In the UK, the rule was also ancient, see for example S. Girvin, S. Frisby and A. Hudson *Charlesworth’s Company Law*, 18<sup>th</sup> ed., London 2010, p. 179-180, including a reference to the 1892 case which established or confirmed the principle, *Oregon Gold Mining Company of India Ltd. V Roper* [1892] A.C. 125. The principle is now established in s. 580 CA 2006.

“8” or “25 p” or possibly “0.33 £”, the par value of a share can also be explicitly expressed as a fraction. Instead of saying that a company with a capital of 1 million has 100.000 shares with a nominal value of 10, the articles could provide that the company has 100.000 shares “*without nominal value*” or “*with an accountable par*” or with a “*fractional value*” (the three expressions are synonymous, or at least are here treated as referring to exactly the same thing) of 1/100.000. Of course this is the same thing as saying that the shares have a par value of 10; it’s simply a different form in which exactly the same situation is expressed, once as a number and once as a fraction.

The 2<sup>nd</sup> Company Law Directive, in its article 8, expressly (although indirectly) allows public companies to adopt such “shares without nominal value”. At the time of the adoption of the original 2<sup>nd</sup> Directive, such shares without a nominal value were only allowed in Belgium and Luxemburg<sup>18</sup>. The reason that article 8 refers to such “shares without nominal value”, which in their country of origin (Belgium) are usually called “shares with a fractional value”, is precisely because Belgium had allowed them for public companies since 1913<sup>19</sup>.

A system based on shares with a fractional value/without nominal value is *exactly the same* as the most inflexible version of a system with nominal values *if* three conditions are met, namely if the fractional value is fixed over time either because the law mandates this directly or because the law prohibits shares with different par (fractional) values, if as a corollary to this the number of shares may not increase disproportionately to increases in the amount of legal capital, and if the rights attached to a share are at least as a default proportionate to the fractional value of the shares. It also helps (but is not strictly necessary) that the fractional value has a minimum amount which has been set by law. As we will explain below, German law is paradigmatic for this approach. In such a case, the difference between shares with and without nominal value is purely formal and the only purpose of shares without nominal value seems to be that they can have par values which are not whole numbers and don’t have to be expressed anywhere so that if par value changes, documents that would otherwise have contained a number expressing a nominal value do not have to be formally amended. However, in spite of doubts among mainly academic lawyers (not so much among practitioners) that only disappeared in the mid 1990s, Belgian firms construed the concept of “fractional value share” in the Belgian Companies Act as something offering far more flexibility than nominal value shares soon after the introduction of such shares in 1913, or at least since the 1940s. These days, there is universal agreement among academics and practitioners in Belgium that this flexible interpretation is the correct one (see below).

I will now first very briefly describe the rigorous German system of shares with and without nominal value to illustrate the traditional approach to par value in all its internal logical consistency, but leading to economic inefficiency (the system creates costs for companies and their creditors while only marginally protecting shareholders, so that on balance the system needs to be evaluated negatively). Like several other European countries, Germany allowed

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<sup>18</sup> Luxemburg originally copied the Belgian companies acts and their amendments and continued to do so until the 1990s, albeit that changes to the Belgian companies act were often adopted with some delay, sometimes never at all. From about 2000, the differences between Luxemburg and Belgian corporate legislation became important as a result of a modernisation effort in Luxemburg independent of what was happening in Belgium.

<sup>19</sup> See the Explanatory Memorandum to the 2<sup>nd</sup> Company Law Directive (only available in French, as far as I’m aware), COM (70) 232 final (available at <http://aei.pitt.edu/8617/>), comments to (then) article 7, p. 25: “*La référence au pair comptable concerne les législations belge et luxembourgeoise qui connaissent les actions sans mention de leur valeur nominale. Le pair comptable s’obtient en divisant le capital social par le nombre d’actions qui le représentent, ou, s’il existe plusieurs catégories de titres, en divisant la partie du capital social représentée par une catégorie d’actions par le nombre d’actions de celle-ci.*”

companies to use “Stückaktien” in addition to traditional nominal value shares. But as I hope to show, “Stückaktien” are really nominal value shares by another name, the differences are almost purely formal. I hope to convince the reader that approaches like the German one do not protect in any way the creditors or shareholders that they are intended to protect, whereas they do make life procedurally and therefore unnecessarily miserable for companies. This will lead me to the conclusion that the EMCA made the right choice in defending the generalized adoption of a true no par value system in both private and public companies.

I will then contrast the German approach with the far more flexible Belgian approach which led to the inclusion in the 2<sup>nd</sup> Directive of the concepts of “shares without nominal value” and “accountable par”. In doing so, I hope to show that without a par value that is fixed over time, the whole par value approach makes even less sense; and that the Belgian approach at heart is the same as a “true no par value system” that has long been common in the US, was introduced in the 1990s in Australia and New Zealand<sup>20</sup> and was wholeheartedly adopted by Finland in 2006, the same year the UK refused to incorporate it in its new Companies Act, in the mistaken belief it was incompatible (for public companies) with the 2nd Company law Directive. There are no substantive differences between the flexible, today generally accepted version of Belgian shares without a nominal value and true no par value shares, the differences are only procedural. It is important to understand the Belgian system, because as already mentioned several times, it was sanctioned by the 2nd Company Law Directive, which allows “shares without nominal value” because Belgium had allowed them for decades.

By discussing how the Belgian system operates during a capital increase, I will show that nominal/par value is not about creditor protection, but about protecting shareholders against dilution. But relying on disclosure and decision rights (requiring general meeting instead of board decisions) is a far more effective and cost-efficient way of protecting against shareholder dilution than using fixed par values.

Next, I will explain that nothing in the 2<sup>nd</sup> company law directive militates against the introduction of true no par value shares. I will then finally describe the Finnish and RMBCA true no par value systems – a system that is also being considered in Poland. EMCA has more or less copied the Finnish approach. The article will conclude with some other rules concerning shares in the EMCA, rules that largely follow logically from the adoption of a true no par value system.

## **2. The German approach: strict and internally consistent but inefficient**

The German *Aktiengesetz* (law on public companies) offers companies a choice between nominal value shares<sup>21</sup> and shares with an accountable par, which it calls “Stückaktien” ( § 8 (1) AktG). Nominal value shares must have a nominal value of at least one euro<sup>22</sup> or a “full” multiple, that is nominal values must be whole numbers (e.g. 120) and must not contain fractions of euros (e.g. 3.33)<sup>23</sup>.

“Stückaktien” (henceforth here also called “shares with an accountable par”) were only introduced after the introduction of the euro would have otherwise forced many existing

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<sup>20</sup> s.254C Australian Corporations Law, inserted by Company Law Review Act 1988; s. 38 New Zealand Companies Act 1993.

<sup>21</sup> “Nennbetragsaktien” in German.

<sup>22</sup> Lower amounts lead to shares that are null and void, § 8 (2) 2nd sentence AktG.

<sup>23</sup> § 8 (2) AktG, last sentence: “Höhere Aktiennennbeträge müssen auf volle Euro lauten”.



companies to adopt shares with a nominal value that would not have been a whole number<sup>24</sup>. A look at the concept of these accountable par shares under German law quickly reveals that these are not true par value shares (“*Quotenaktien*” in German) but really simply par value shares whose par value has not been explicitly expressed<sup>25</sup>. § 8 (3) AktG defines shares with an accountable par as shares without nominal value, and adds that the part of legal capital each such share represents may not be lower than one euro<sup>26</sup> (just like the nominal value of shares with nominal value may not be lower than 1 euro). Moreover, all shares must represent an equal part of the company’s legal capital.<sup>27</sup> It is telling that the part of the legal capital that such a share represents, is also called its “fictitious nominal value” (“*fiktiver Nennbetrag*”<sup>28</sup>, perhaps better translated as “assumed nominal value”). The whole set of rules is completed by a rule in § 182 AktG dealing with capital increases. § 182 (1) last sentence states that in companies that use “*Stückaktien*”, the number of shares must increase proportionate to the increase in share capital. A leading commentary states: “In this way, the [Act] protects the interest the existing shareholders have in a proportionate participation” [in the capital increase and hence in total share capital after the increase]<sup>29</sup>. The Dutch scholar Schutte-Veenstra gives the following example of what this means<sup>30</sup>:

Assume a German AG with a legal capital of 1.000.000 euro consisting of 10.000 *Stückaktien*. The par value/fractional value of each share is 100 euro. The AG decides to increase its capital with an amount of 500.000 euro. As a consequence of § 182, the only possibility for this company is to issue 5000 new shares at a price of 100. It is not possible to issue 10.000 new shares for a contribution of 50 per share, because this would result in a legal capital of 1.5 million divided by 20.000 shares with a hypothetical<sup>31</sup> fractional value of 75 each. This would mean that the total share of the old shareholders in legal capital would have decreased from 100 per share to a hypothetical (because under German law not permitted) 75 per share, as a result of a disproportionate number of new shares having been issued compared to the contributions being paid in (100% increase in number of shares whereas legal capital only increases 50%).

The German approach is straightforward and clear and internally consistent: shares have a par value; all shares have the same par value (although classes of shares are possible, but not multiple voting rights); the rights attached to shares are proportionate to this par value; this value is fixed in time and therefore new shares will have to be issued at or above the par value

<sup>24</sup> This was done by an Act dated 25 March 1998 as extensively discussed in Vetter, “Verpflichtung zur Schaffung von 1-Euro Aktien?”, *Die Aktiengesellschaft* 2000, 193 ff.

<sup>25</sup> Cf. H. Ziemons, comments to § 8 AktG in Schmidt/Lutter (eds.), *Aktiengesetz Kommentar*, Band I, 3rd edition, 2015, Köln, § 8 nr. 3, p. 225.

<sup>26</sup> If it is a multiple, it must not necessarily be a whole number as is the case with nominal value shares, “fractional” accountable pars are permitted, see H. Ziemons, comments to § 8 AktG in Schmidt/Lutter (eds.), *Aktiengesetz Kommentar*, Band I, 3rd edition, 2015, Köln, § 8 AktG, nr. 12, p. 227 and Heider in *Münchener Kommentar AktG*, 3. Aufl. § 8 AktG nr. 81. If this were not the case, the whole purpose of the introduction of “*Stückaktien*” after the euro would have been defeated.

<sup>27</sup> § 8 (3): “*Stückaktien lauten auf keinen Nennbetrag. Die Stückaktien einer Gesellschaft sind am Grundkapital in gleichem Umfang beteiligt. Der auf die einzelne Aktien entfallende anteilige Betrag des Grundkapitals darf einen Euro nicht unterschreiten. (...)*”.

<sup>28</sup> See H. Ziemons, comments to § 8 AktG in Lutter/Schmidt (eds.), *Aktiengesetz Kommentar*, Band I, 3rd edition, 2015, Köln, § 8 nr. 12, p. 227, with a reference to the government’s explanatory memorandum to the Act introducing accountable par shares in Germany, where this expression was also used.

<sup>29</sup> R.Veil, comments to § 182 AktG in K. Schmidt /M. Lutter (eds.), *Aktiengesetz Kommentar*, Band II, 3rd edition, 2015, Köln, § 182 nr. 3, p. 2802: “*Auf diese Weise schützt die durch das StückAG vom 25.3.1998 eingeführte Vorschrift das Interesse der Altaktionäre an einer proportionalen Beteiligung*”.

<sup>30</sup> J.N. Schutte-Veenstra, “Denominalisatie van aandelen” in *A-T-D. Opstellen aangeboden aan prof. mr. P. van Schilfgaarde*, Kluwer, 2000, p. 385-86.

<sup>31</sup> I write “hypothetical” to make clear that this is not allowed under German law.

of the already existing shares, unless there first is a formal capital reduction in which the nominal value of the existing shares is lowered; therefore “historical par value” plays its potential function in protecting shareholders against dilution. If a legal system attaches *any* importance to par value, it should adopt this *complete* set of rules, as Germany has consistently done. French law is similar to German law in this respect<sup>32</sup>, as is the law for those Belgian companies (a minority) who still choose<sup>33</sup> to use nominal value shares<sup>34</sup>. UK law, by contrast, imposes the use of nominal value shares and has a no discount rule, but it is relatively easy to get around/deviate from the rule that shareholder rights are proportionate to par value and to create classes of shares<sup>35</sup>, so that in the UK it is even more questionable that nominal value serves any purpose at all.

Our main point is, however, that even a strict regime along German lines does not protect creditors at all, and is of very little effective use in protecting shareholders against each other (the only real potential use of the par value concept). In order to clarify and underpin these statements, we will now first look at the Belgian system of shares without nominal value that inspired article 8 of the 2<sup>nd</sup> Company Law directive in order to be better able subsequently to demonstrate the inefficiency of the par value system as favored in e.g. German law.

### 3. The Belgian system as inspiration for the 2<sup>nd</sup> company law directive

Belgium has been a pioneer in Europe in allowing “shares without a nominal value” also called “fractional value shares”, since 1913<sup>36</sup>, and contrary to what mostly foreign

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<sup>32</sup> For a description of French rules, see e.g. Ph. Merle, *Sociétés commerciales*, 16<sup>th</sup> edition 2013, Paris, Dalloz, p. 327 and specifically for proportionality between voting rights and par value, except for the system of double voting rights, p. 373-375.

<sup>33</sup> Usually these are private companies that, probably because of inertia rather than as a result of a conscious decision, have not yet changed their articles since a 1995 law allowed private companies, too, to use shares without nominal value (for public companies, the possibility had already been explicitly written into the statute in 1913, as indicated earlier). Some/most of these companies have probably not gone through a capital increase since 1995. I have no knowledge of systematic empirical research in this respect, but it is generally assumed among Belgian corporate law practitioners that hardly any newly set up Belgian company opts for nominal value shares. This fact in itself casts doubt on the thesis that nominal values and the par value rules attached to them protect shareholders in a meaningful way. If they did, why would virtually no company founders opt into the nominal value system when given a choice?

<sup>34</sup> See T. Tilquin, “Les actions et parts sans valeur nominale en droit belge”, *Bulletin Joly Sociétés*, 1998, 738-754 for an overview of the Belgian no par value system intended for a non-Belgian audience not familiar with the Belgian debate.

<sup>35</sup> See e.g. P. Davies and S. Worthington, *Gowers and Davies' Principles of Modern Company Law*, London, 9<sup>th</sup> ed. 2012, pp. 273 and 819-820 for a clear description of how easy it is, as a matter of law, to create disproportionate shareholder rights under UK law.

<sup>36</sup> For public companies (NV/SA). For private companies (BVBA/SPRL) this has only been allowed since 1995. However, it can be argued that shares without a nominal value had always been allowed in Belgian public companies. Art. 35 of the original 1873 Belgian Act on Public Corporations (*société anonyme- naamloze vennootschap* -type) simply stated: “*Le capital social se divise en actions*” (“legal capital is divided in shares”) and in practice this was apparently regarded as allowing companies to operate with shares without an expressed nominal value (nowhere did the 1873 corporations act mandate the expression of nominal value). A law of 25 May 1913 simply explicitly confirmed this opinion, oddly without any indication of the reasons why this practice had to be legitimized. Doctrine pointed towards “pressure from practice”. Also, in Belgian doctrine prior to 1913, no explicit distinction was made between shares with and those without nominal value, it was simply assumed that par value did not have to be expressed on the shares (if they were printed as certificates) or in any corporate document such as the articles. After the first world war, it was apparently rampant inflation that induced many companies to use shares without an expressed nominal value since nominal value figures seemed meaningless. There was also a political element to this: because of inflation, annual dividends that represented relatively modest amounts were often equal to or larger than nominal values, thus giving rise to accusations by representatives of “ordinary workers” that “capitalist pigs” were pocketing returns of more than 100% while

commentators regularly write<sup>37</sup> based on the fact that such shares technically also have a par value, the way the Belgian system operates does lead to shares without nominal value that are emphatically *not* mere varieties of nominal value shares: their par value is not fixed, so that it is largely meaningless (see below). At the same time, Belgium has for decades had strict rules on the proportionality between on the one hand nominal or fractional value of shares (what Belgian scholars collectively call the “legal capital value” of shares) and the rights attached to the shares on the other. In 1934, a law was enacted that mandated the one share one vote rule in the sense that it was made mandatory to have voting rights attached to shares proportionate to the amount (percentage) of capital they represented.<sup>38</sup> The system of shares without nominal value expressly permitted in 1913 raised no issues in practice until 1948, when a financial markets supervisory agency, the so-called Belgian Banking Commission<sup>39</sup> critically commented on the practice it had observed among listed firms to issue new shares for a price below the par value of the existing shares, but with these new shares having exactly the same rights (to profits as well as voting rights) attached to them as the old shares<sup>40</sup>. This could lead to possible financial and/or power dilution of the existing shareholders. This led to a first outpouring of debate about the issue, since it was clear that firms had been using this technique for many years and were convinced it was legitimate, whereas academic opinion was divided, in that some academics shared the doubts of the Banking Commission. The Commission mainly stressed that companies ought to draw the attention of their shareholders to the consequences of the transaction, and deemed the technique of issuing new shares “below par” -of the old shares- permissible as far as it merely implied a unification of profit rights attached to shares that had been issued for a different contribution, but had its doubts about the legality of such an approach when it came to voting rights, in view of the statutory rule (1934) mandating voting rights equal to the fractional value of the shares. The respected author Heenen pointed out that such a transaction could nevertheless be justified in case of losses<sup>41</sup>, i.e. where the actual book value of the existing shares was lower than their par value.

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workers were suffering from unemployment and low wages. The tax authorities, too, frowned upon these “enormous” paper gains. See for all this historical background M. Wyckaert, *Kapitaal in N.V. en B.V.B.A.*, Kalmthout, 1995, 631-634, with further references to pre-world war II doctrine; as well as the seminal contribution by J. Heenen, “L’existence et l’opportunité des actions sans valeur nominale dans les sociétés anonymes”, *Rev. Dr. Int. Comp.* 1950, 75.

<sup>37</sup> E.g. J. Rickford, “Reforming capital: report of the interdisciplinary group on capital maintenance”, *EBOR* 2004, p. 229, approvingly referenced by L. Gullifer and J. Payne, *Corporate Finance Law*, Oxford and Portland, 2<sup>nd</sup> ed. 2015, p. 154, footnote 56. Allow me to stress I do not want to single out these excellent authors for criticism, because there are many who have written the same as they do (namely that Belgian shares without nominal value are not “true” no par value shares; which is technically correct but substantially wrong), and also because the actual operation of the Belgian law is important to understand it’s true meaning, but hard to get at for those not reading French and Dutch.

<sup>38</sup> Meaning that, theoretically, shares with more than one vote attached to them were not only possible, but mandatory in cases where a company had issued shares at different “capital values” (nominal values, par values) (these shares would be considered different classes in many countries because of the different rights attached to them. Under Belgian law, they do not constitute different classes, since the different rights are proportionate to “capital representative value”, i.e. nominal or par value.). The 1934 law is the Royal Decree nr. 26 [an act of Government adopted in a crisis situation and therefore with the same legal value as an Act voted by Parliament] of 31 October 1934. What all this means is that it is arguably by no means certain that the Belgian legislator of 1873, 1913 or 1934 ever had “true no par value” shares in mind. But as explained in the main text, the statutory possibility of issuing shares without an expressed nominal value *was*, at least since the 1940s but probably already earlier, used by firms to issue true no par value shares.

<sup>39</sup> Then the regulatory agency, set up in 1933, in charge of both banking supervision and capital markets, including prospectus rules. This agency is now called FSMA and its banking supervision role has been transferred to the National Bank of Belgium (and the ECB).

<sup>40</sup> Banking Commission, *Annual Report 1947-48*, Brussels, p. 72-76.

<sup>41</sup> J. Heenen, “L’existence et l’opportunité des actions sans valeur nominale dans les sociétés anonymes”, *Rev. Dr. Int. Comp.* 1950, 81-82.

Contrary to what the Banking Commission seemed to imply it is unclear that any company had ever tried to use the technique in a situation where there were no losses and there consequently had been no difference between book value and par value, the former being lower than the latter.

The ensuing doctrinal debate essentially centered on the question whether par value in the sense of fractional value had to be determined taking into account “*historical values*”, i.e. the actual amount of the contribution paid by the subscriber to the shares<sup>42</sup>, or whether on the contrary a “*pure accountable par*” approach was permitted. The latter approach means that par value is simply determined by dividing legal capital by the number of shares, irrespective of the contribution paid for the share or the part of the subscription price initially booked as legal capital *so that each share has the same rights attached to it* unless classes of shares have explicitly been formed (the technique somewhat criticized by the Banking Commission in 1948). As a consequence, when a company increases its capital through the issuance of additional, new shares for a price that is below the par value of the old, existing shares, the new shares will nevertheless have exactly the same rights as the old ones. In spite of the doctrinal debates during the 1950s, firms seemed unfussed, and applied, without further ado, this “pure accountable par” approach<sup>43</sup>. After the 1950s the issue more or less died down until the early 1990s, when a law review article defended the “historical par value” approach<sup>44</sup>. This sent a cold shiver down the spines of corporate law practitioners and as a reaction a prominent practitioner-professor wrote the definitive article explaining why pure accountable par is not only perfectly legitimate but also the norm under Belgian law and why it is the best practical solution<sup>45</sup>. Since that article, the matter has not been contested anymore and both academia and practitioners (lawyers, accountants and auditors) unanimously apply the pure accountable par method, in which historical par value plays no role and it is possible without formally changing par values through e.g. a change to the articles in the form of a capital reduction to issue new shares for a price which is below the par value of the existing shares and automatically grant each share the same, newly equalized, par value and therefore the same rights.<sup>46</sup>

Let’s further illustrate the by now traditional Belgian approach with the example of a capital increase with issuance of new shares in a situation where the book value of the existing shares is clearly below their “fractional value”. Suppose a company with a legal capital of 10 million that has issued, upon its formation, 1 million shares, each representing 1 millionth of legal

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<sup>42</sup> Under such a historical par value system, shares have no expressed nominal value, and new shares can be issued for a different contribution than had been paid for the pre-existing shares. But if new shares are issued against a lower contribution than existing shares, fewer rights (e.g. lower voting rights, lower profit rights) will be attached to them, proportionate to this lower contribution.

<sup>43</sup> See references in M. Wyckaert, *Kapitaal in N.V. en B.V.B.A.*, Kalmthout, 1995, p. 639, esp. footnote 2232. These references to practitioners’ handbooks and in fact mainly to accounting treatises convincingly show that practitioners assumed the pure accountable par approach was the standard, normal approach.

<sup>44</sup> M. Wyckaert, “De bepaling van de fractiewaarde van aandelen zonder nominale waarde in de N.V., en van de aan deze aandelen verbonden Rechten”, *TRV* 1991, p. 381. M. Wyckaert has long since switched sides in the debate, see note 46.

<sup>45</sup> J.-M. Nelissen Grade, “La détermination de la partie du capital représentée par une action sans désignation de valeur nominale dans la société anonyme”, in *Hommage à Jacques Heenen*, Brussels, Bruylant, 1994, 337.

<sup>46</sup> See e.g. T. Tilquin, “Les actions et parts sans valeur nominale en droit belge”, *Bulletin Joly Sociétés*, 1998, 738. And indeed Marieke Wyckaert has now vigorously defended the pure accountable par method, see M. Wyckaert and F. Parrein, “Kapitaal: een mythe van kapitaal belang?” in *Overzicht nieuwe wetgeving vennootschappen 2007-2011*, (Jan Ronse Instituut ed.) , Kalmthout, 2011, p. (46), 83-96. Her published Ph.d. had already gone over largely to the pure accountable par view, albeit with some reluctance and reservations, see M. Wyckaert, *Kapitaal in N.V. en B.V.B.A.* , Kalmthout, 1995, 641-705.

capital and thus having an accountable par (par value) of 10. As a result of losses, the book value of these shares is only 8 per share, so in total 8 million. Suppose the company needs a capital injection in order to survive. It decides to issue 1 million additional shares. If it demands an issue price of 10 per share, the new shareholder overpays and will only be prepared to do this if he gets preferential rights. What a Belgian company will typically do – and which it is allowed to do, whereas a German company, for example, could not do this in the same way- is issue one million shares for a price of (maximum) 8 euro per share. After this capital increase, the company will have legal capital of 18 million, divided by 2 million shares. For a legal second, the newly issued shares will have an accountable par (par value) of 8, whereas the old shares have par value of 10. However, immediately after voting the capital increase, the same general meeting will vote to unify these categories of shares, determining that each represents one 2millionth part of legal capital of 18 million, with each share consequently having the same accountable par of 9 and the same rights attached to them, since they represent an equal part of legal capital (they have the same “fractional value”). From an economic perspective, this is the same as having pure no par value shares, but with a procedure that’s more cumbersome: the general meeting needs to “unify” two classes of shares that existed for a legal second. The rules on changes to class rights –which basically imply that each class has to approve the transaction with a 75% majority within each class<sup>47</sup>- do not need to be applied to this situation, since the only two possible classes imaginable would be the existing and the new shareholders, but the existing shareholders have to approve the transaction at general meeting with a 75% majority anyway, and each subscriber to the newly issued shares will have given his individual consent to the transaction.

Of course, the whole transaction could seriously dilute existing shareholders if the new shares are issued at a price that is substantially below the book value of the old shares<sup>48</sup>. In practice, this often happens, with the fully informed knowledge of the existing shareholders, who have to approve the capital increase and the subscription price with a 75% majority. They consent to this dilution because they realise it may be the only possibility, in view of market conditions, to get the shares sold and attract a sufficiently large capital injection that can save the company from even more severe financial distress. This capital injection in a company in financial distress is obviously beneficial to the company’s creditors. The converse could also happen: if the price for the new shares is set too high, it might nevertheless be possible to convince gullible investors to buy them in spite of the fact that their shares will immediately be diluted. For these reasons, the Belgian Companies Act is right in attaching great importance to disclosure: art. 582 of the Act mandates the board of directors to draw up a report detailing the way in which the issue price was determined, justifying it, and describing the financial consequences for shareholders of agreeing to an issue at the proposed price with a subsequent unification of all share categories<sup>49</sup>. This report has to be made available to shareholders well in advance<sup>50</sup> of the general meeting that is being asked to approve the capital increase, together with a report by the company’s external auditor who has to check the reliability of the financial data in the board’s report and has to judge whether they are sufficient to inform the general meeting. A last safeguard is that this kind of capital increase – new shares issued below the par value of the existing shares- can never be performed by the board of directors using authorised capital<sup>51</sup>.

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<sup>47</sup> Art. 560 Belgian Companies Code.

<sup>48</sup> Or below current stock prices at the stock exchange, for listed companies.

<sup>49</sup> Again, these are not classes according to Belgian law.

<sup>50</sup> At least 15 days.

<sup>51</sup> Art. 606, 2° Belgian Companies Act.

This by now uncontroversial Belgian approach protects the interest of stakeholders at least as well as the more formal approaches in other European countries (with the exception of Finland), with Germany being the epitome of consistent but inefficient formalism in this regard.

The question which stakeholder interests are allegedly protected by rules on par value, and in what way, does indeed warrants some attention. It is by no means self-evident that par value rules have any role in protecting a company's creditors<sup>52</sup>.

### **III. Do par value rules offer protection to any stakeholders?**

#### **1. Creditors or shareholders as the intended beneficiaries –or both?**

It sometimes used to be said –and one may assume that in the 19<sup>th</sup> century, this was the original idea behind the concept of nominal value- that nominal /par value protects creditors, in that they could rest assured that shareholders would have actually paid in, or would at least have committed to pay in on first demand an amount corresponding to nominal value for each share. But this idea has never been convincing, and has lost all its power now that many legal systems that mandate nominal value allow companies to fix this value at a very low level – e.g. 1 penny. This has led at least one commentator, in a much-used and authoritative German commentary, to express serious skepticism about, in fact hostility towards, the idea of penny stocks<sup>53</sup>. I fail to see, however, how issuing, say, 10.000 shares of 25 euro each would better protect creditors than having 1 million shares of 0.25 euro. It's true that if the nominal value is 25, when new shares are issued, at least 25 euros of the subscription price –let's assume it is 80- will have to be booked as capital, and capital, of course, cannot be distributed to shareholders and in that sense protects creditors. If nominal value is only 0.25, virtually all the subscription price can be booked as a share premium, and rules on whether share premiums can be distributed differ from country to country, but in some countries they can be distributed as easily as regular retained earnings. What this makes clear is that creditors do not receive protection through nominal share amounts, but through rules on distributions and the real question is whether these are best governed by a balance sheet test, a solvency test, a liquidity test or some combination of these. In any case, in existing nominal value systems, capital is often a negligible amount compared to share premiums. Moreover, shares will of course not be issued, in the above example, for 25 euros when this is more than their economic value. In that case there will be either no capital increase –very much to the detriment of creditors - or the nominal value of the existing shares will first be lowered to an amount corresponding to the economic or to the book value of the shares through a cumbersome procedure of capital reduction, which offers no meaningful creditor protection

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<sup>52</sup> Nevertheless, several authors seem to think that par value rules protect creditors, beyond the obvious principle that if shares have a nominal value or par value expressed as a fixed fraction of capital, the contribution paid for such a share should be at least as high as that nominal/par value. See for example J.N. Schutte-Veenstra, "Denominalisatie van aandelen" in *A-T-D. Opstellen aangeboden aan Prof. mr. P. van Schilfgarde*, Deventer, 2000, (375), p. 377-78 where she writes that the choice between par value and true no par value shares determines the way company creditors are protected. In her view the use of fixed par values is linked to a system where creditors are protected through rules on the formation and maintenance of legal capital (p. 378). The Belgian and Finnish approaches prove that there is at least no necessary link. For the more or less opposite argument, which I find more convincing, that the current (French) system of par values has many holes in it when it comes to the protection of stakeholders (creditors or others), see J. Abras, "Augmentation de capital par apport en numéraire dans les sociétés par actions non cotées. Les faiblesses de la protection contre les abus dans la fixation du prix des titres nouveaux: l'exemple de la SA", *JCP Entreprise (La semaine juridique – édition entreprise et affaires)*, 2009, 1317 (issue 13, March 2009, p. 33-39).

<sup>53</sup> U. Hüffer and J. Koch, *Aktiengesetz*, München, 2014, comments to § 8 AktG.

but does impose an administrative burden on companies. In addition, the concept of par value as a creditor protection mechanism is unconvincing for the same reasons that rules on minimum capital are unconvincing, unless they are as sophisticated as capital requirements in the financial sector: the amount of minimum capital in unregulated, non-financial companies bears no relation to the actual risks created for creditors by the company; in the same way the amount of nominal value is purely symbolic.

In American literature about legal capital –in which the concept of par value is invariably and rightly criticized<sup>54</sup> - it is regularly argued that the original function of par value and the “no discount” rule was to protect *shareholders* against the company: a shareholder could rest assured that once he had fully paid up an amount equivalent to the nominal value stated on the share, the company could claim no additional contributions from him<sup>55</sup>. The nominal value therefore indicated the full obligation of the shareholder to the company, so the assumption goes. Of course this idea too deserves to be called simple-minded, since it seems to assume that shareholders will never be contractually obliged to pay a share premium, whereas often they are, of course.

The real potential of par value- nominal value or historical par value- lies in the protection it can offer *shareholders* against each other in an *intertemporal framework*<sup>56</sup>, provided the rights attached to the shares are *mandatorily* proportionate to their par value, a rule that is not present in several legal systems that nevertheless impose the use of par values on their companies. This means shares must be issued for their “historical” par or fractional value and this determines the rights attached to the shares. However, the costs created by this system outweigh the benefits. Rather than forcing the company into a straightjacket when it issues new shares, shareholders can be protected through a mix of decision rights- the requirement for the general meeting to approve certain issues that could adversely impact existing shareholders- and directors’ duties – the duty of directors to determine an issue price for the new shares that strikes an acceptable balance between the interest of existing shareholders and the need to market the shares in order to attract financial means for the company, and the duty of directors to inform all parties involved (old and prospective shareholders) about the financial and governance impact of the issue share (threat of financial or/and (voting) power dilution of existing shareholders).

We can explain the above by discussing the role of par value during capital increases, when the company issues new shares. It’s on that occasion that the difference between a nominal value system or system and a fractional value system operating with true accountable pars becomes most apparent.

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<sup>54</sup> The in a certain way magnificent handbook of B. Manning (and for the 1990 edition J.J. Hanks), *Legal capital: being a concise practical exposition with illustrative examples*, New York, 1990, while probably being the most comprehensive technical description of legal capital in American literature, is filled from start to finish with mockery of the whole concept of legal capital in general and par value in particular.

<sup>55</sup> Among many, see e.g. J. Bonbright, “The dangers of shares without par value”, 16 *Columbia Law Review*, 1924, p. 450. Between the 1920s and 1940s, the relative merits of par value and no par value shares were quite extensively discussed in American law review articles, see the references in J. Cox and T. Hazen, *Treatise on the Law of Corporations*, 3<sup>rd</sup> edition, West, 2010, Vol. 3, esp. p. 320 footnote 3.

<sup>56</sup> See already M. Lutter, *Kapital, Sicherung der Kapitalaufbringung und Kapitalerhaltung in den Aktien- und GmbH-Rechten der EWG*, Karlsruhe, 1964, p.161 who writes, correctly, that under a system like the Belgian one, the question whether the par value of shares without nominal value is determined by the value of the contribution or, on the contrary, simply by dividing capital by number of shares, has nothing to do with the problem of issues below par, but is “merely” a question of relationships between shareholders. See also P. Davies and S. Worthington, *Gowers and Davies’ Principles of Modern Company Law*, London, 9<sup>th</sup> ed. 2012, 276, 11-5, who write that the “no discount rule” might be better understood as a shareholder protection rule.

## 2. The role of par value when new shares are issued, and how legal systems get around par value's undesirable effects

When a company decides on a capital increase, chances that the book value or market value of the existing shares is the same as their nominal value are vanishingly rare.

### *a. the lack of rules on share premiums undermines claims about stakeholder protection*

When book or market value of the existing shares is substantially higher than their nominal value, companies usually ask for a share premium when they issue new shares in order to limit dilution of the existing shareholders. Still, some dilution is quite common, because in order to be able to market the shares and be sure that the company actually succeeds in selling them, a discount often has to be offered<sup>57</sup>. In any case, part of the contribution paid for each share will be booked as legal capital –namely the part corresponding to the nominal value of the existing shares- and part as share premium.

Please note that those legal systems that allegedly attach so much importance to creditor and shareholder protection through legal capital, do not have binding bright line company law rules on share premiums. It may be a directors' duty to demand a share premium in certain circumstances, but, understandably<sup>58</sup>, companies acts do not contain rules on this. For example, German, French or Dutch companies acts do not contain a rule stating that a share premium has to be demanded in case book value of existing shares exceeds their nominal value with a certain percentage. And once a share premium has been asked for and received, most companies acts are notoriously vague (or silent) about how this has to be treated<sup>59</sup>. In the UK, consensus seems to be that share premiums are more or less treated like legal capital when it comes to distributions<sup>60</sup>, whereas in Belgium share premiums are simply made undistributable by companies because otherwise they are taxed as profits. But a company that is willing to bear this tax burden, can, with a 75% majority vote at general meeting and nothing else (no creditor rights), decide to turn share premiums into distributable reserves. The point is that the lack of clear legal rules on share premiums makes the claim that a nominal value system protects creditors or shareholders sound even more hollow. Admittedly, it may be difficult to draft meaningful let alone efficient bright line rules about share premiums. But this cannot be used to support a nominal value system. It simply reinforces

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<sup>57</sup> One reason also being that both book values and market values as expressed, for listed companies, through the stock price on the exchange, are both ephemeral, volatile and a poor indicator of the book value and market price in the near future. Even in an unlisted company, book values often fluctuate substantially from one period to another, for instance because some reserves are distributed, provisions for risks disappear because they turn out to have been unwarranted or "revaluation reserves" are lowered because it appears they were founded on overly optimistic revaluations.

<sup>58</sup> Because it would be hard to draft bright line rules on this issue that are not inefficient, in that they limit discretion of the board and thereby force decisions upon the company that are either detrimental to the existing shareholders or to new investors, or to both in that new investors are de facto robbed of an investment opportunity (because the price the law forces them to pay for the shares is unacceptably high) and the company therefore does not receive the financing it is (sometimes desperately) seeking.

<sup>59</sup> For an overview, see J. Rickford, "Reforming capital: report of the interdisciplinary group on capital maintenance", *EBOR* 2004, p. 919. The 2nd EU Company Law Directive contains no rule requiring share premiums to be treated in the same way as legal capital or indeed in any other way; see, among many, E. Ferran, *Principles of Corporate Financial Law*, Oxford, 2008, 217.

<sup>60</sup> P. Davies and S. Worthington, *Gowers and Davies' Principles of Modern Company Law*, London, 9<sup>th</sup> ed. 2012, 268, nr. 11-8 writes that for capital maintenance purposes, share premiums have been treated in the same way as capital since 1948, with some exceptions mentioned in s. 610 CA 2006.



calls for taking directors' duties seriously in this area, trying to make these duties enforceable by shareholders and perhaps in certain circumstances, creditors, and allotting decision making powers between board and general meeting of shareholders in such a way that shareholders can protect their own interests without totally undermining the technical workability of capital increases. The different ways legal systems handle *these* issues has a large or at least meaningful impact on creditor and shareholder protection. Strict rules about nominal/par value, on the other hand, have no significance at all for these issues. It is by now well known, and despite changes in both legal systems still true, that EU corporate law gives more decision making powers to shareholders than the US system, but makes the enforcement of directors' duties by shareholders far more difficult, in practice, than in the US, which itself does not have an ideal system. This is a relevant difference in approaches to stakeholder interests, whereas as indicated the rules on par value make no difference. Indeed, most US states offer corporations a choice between par and no par value shares and many large US corporations still operate with par value shares, but with extremely small nominal values<sup>61</sup>; nominal and no par value companies are not perceived differently by creditors or investors.

*b. when a stock's value is under water: fortunately creative lawyers are at hand to evade the par value requirements*

In case the book or market value of the existing shares is lower than their nominal value, no rational investor will buy new shares at the nominal value of the old ones, thereby being immediately diluted. This is probably the biggest practical disadvantage created by a system

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<sup>61</sup> Apple, a company not these days normally associated with outdated practices, suggested to its 2013 annual general shareholders' meeting that it should switch to par value shares, with a par value of 0.00001 US Dollar. Apple had been incorporated in California and until then used no par value shares. But some US states in which Apple did business, like Delaware, calculated certain taxes and other fees Apple had to pay based on the par value of the shares and if a company used no par value shares, a hypothetical par value would be calculated by the State, sometimes leading to figures that were higher than they would have been if Apple had itself chosen to use par value shares with a low par value. See O. Thomas, "Here's why Apple just said its stock should only be worth 0.00001 dollar", December 27 2012 at <http://www.businessinsider.com/apple-par-value-shares-2012-12?IR=T> (last consulted December 28 2015). The relevant part of Apple's proxy statement - available at <http://www.sec.gov/Archives/edgar/data/320193/000119312512515422/d450591dpre14a.htm> - read as follows (see p. 40-41 of the proxy statement): "*Establishing a Par Value for the Company's Common Stock. The proposed amendment of the Articles would also amend Article III of the Articles to establish a par value for the common stock of \$0.00001 per share. Currently, the Company's common stock has no par value. The Company anticipates that establishing a par value of \$0.00001 per share will reduce corporate expenses and thus benefit the shareholders. Under the laws of the State of California, which is the state in which the Company is incorporated, a corporation may have par or no par value stock. However, some other states impose qualification or licensing fees on foreign corporations to transact business in such states based upon the authorized capital stock of a corporation. In certain states, the rates at which qualification or licensing fees are assessed differ, depending upon whether the shares of the corporation are with or without par value, with nominal par value shares being assessed at a lower rate than no par value shares, in some cases. The Company believes that adopting a nominal par value for its shares will, in some cases, result in the Company being assessed qualification or licensing fees on a similar basis as other companies that also have a nominal par value for their shares. Establishing a par value for the Company's common stock will have no effect on any of the rights and privileges now possessed by holders of common stock. The Company does not expect that establishing a par value for the Company's common stock will have any material accounting impact.*"

As "Business Insider" pointed out: "*Apple has 940.7 million shares outstanding, so setting its par value at \$0.00001—a thousandth of a penny—would put the technical value of the company's capital stock at \$9,407. Apple's obviously worth a lot more—that figure just illustrates the degree to which par value has become an abstract accounting concept.*"

The proposal was adopted by Apple's general meeting and Apple subsequently issued new shares with a par value of 0.00001 US dollar. See, for example an April 2015 employee stock plan where 50.000.000 shares were offered at a maximum price of 124.7 US dollar, but a nominal par value of indeed 0.00001: <http://investor.apple.com/secfiling.cfm?filingid=1193125-15-153187&cik=320193>.

with fixed nominal or par values like the German one. Even in Germany, the system of fixed par values, implying that new shares cannot be directly issued at a price lower than the (same) par value of the already existing shares, has been criticised. One author wrote already in 1973 that in case of capital increases, the no discount rule was “problematic”. He convincingly pointed out that creditors are not protected by the rule, since the rule does not imply at all that creditors will find at their disposal assets at least equivalent to the amount of capital. Creditors, the author contended, would rather see new financial means flow to the company, but this is made difficult by the ban on below par issues<sup>62</sup>. Unfortunately, more recent scholarship criticises this sensible point of view that goes to the heart of the matter, pointing out that it’s possible to solve the issue through a capital reduction preceding the capital increase, where during the capital increase shares are issued at the same par value as the existing shares<sup>63</sup>. Apart from the practical and tax difficulties such an operation may bring with it, the capital reduction does nothing to improve the economic situation of the company or of its creditors, and therefore does not make the company more attractive for investors<sup>64</sup> or creditors. True, in some countries even such a formal capital reduction, which does not result in any assets leaving the company, will have to be approved by a court, at least when creditors demands this. This is an excessive requirement since a formal capital reduction has no immediate impact on creditors whatsoever, only on future possibilities to distribute dividends under a balance sheet test along the lines of art. 15 2<sup>nd</sup> Company Law Directive.

Under a strict par value regime, the company that wants to go ahead with the capital increase while the market value of its shares is below their value, has (probably a maximum, depending on the specifics of national company acts, of only) three possibilities. Fortunately these techniques allow companies to evade the meaning of par value, which proves the whole point that the concept offers no real protection to anybody. “Fortunately”, because otherwise companies in distress could not get their hands on the financial injections they need to survive.

Suppose the company has shares with a nominal value of 100 but a book value of 80. The first possibility is that it calls a general meeting which decides on a (purely formal<sup>65</sup>) reduction of capital, thereby reducing the nominal value of the existing shares to 80<sup>66</sup>. Usually, this will entail a change to the articles and a formal capital reduction, or one of those. If the formal capital reduction entails that losses the company had incurred are set off against legal capital, this may have as a consequence, under certain national tax systems, that these former losses, now gone for accounting and tax purposes, are no longer available to be set off against future profits, a situation the company will regret. In any case, after the company has formally decreased the nominal value of existing shares to 80, it can then issue the new shares at price of 80 and with a nominal value of 80. The whole operation is a purely formal one and entails no safeguards for any stakeholders. True, the general meeting will have to approve the operation with the same majority as required for changes to the articles, but under European

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<sup>62</sup> Eckardt, comments to § 9 AktG in Gessler, Hefermehl, Eckardt, Kropff *Aktiengesetz. Kommentar*, Vahlen, München, 1973 p. 137, nr. 2.

<sup>63</sup> For example, with a clear description of the technical rules and references to other German authors who share her opinion, described as “the clearly dominant opinion”, B. Dauner-Lieb, comments to § 9 AktG in Zöllner/Noack (eds.), *Kölner Kommentar zum Aktiengesetz*, Köln, 2010, 3<sup>rd</sup> ed. Band 1. 2. Teillieferung, § 9 nr. 13, p. 95.

<sup>64</sup> Eckardt, footnote 61.

<sup>65</sup> In the sense that no assets leave the company.

<sup>66</sup> See for this solution in Germany, U. Hüffer and J. Koch (eds). *Aktiengesetz*, München, 2014, § 9, nr. 4 (p. 52). The author calls this “the right way (“Der richtige Weg”)", drawing the conclusion of [the need for] a capital reduction from the already occurred negative evolutions”. The moralistic undertone seems striking to me.

law the same goes for any capital increase (outside the limits of authorised capital) where new shares are issued.

The second possibility is to henceforth operate with (at least) two classes of shares, each with a different nominal value, provided the legal system allows this, and consequently attach different rights to the shares. Companies usually want to avoid this in a system that mandates proportionality between (voting) rights attached to shares and their nominal value. It means operating with different classes of shares, which can get very complicated if one is dealing with a relatively old company that has gone through several capital rounds, each resulting in shares with different rights attached to them than the shares issued earlier. Calculating majorities at general meetings and knowing how to calculate correct dividends per share can get seriously complicated, even setting aside the fact that in public companies the lack of transparency about the financial structure of the company this entails is not appreciated by investors. Of course, one could argue that this difficulty can be eliminated through a merger of different share classes, for which company law contains procedures. These procedures will contain safeguards for shareholders, thus leading to the best of both worlds: after the unification of classes the practical problem of dealing with several different classes has obviously gone, and this has happened through a procedure which gave decision making powers to shareholders –it’s the shareholders, after all, that might be affected by “wrong” issue prices and that the rules on par value intend to protect. This line of argument overlooks that it’s far more practical and less cumbersome to protect shareholders through a system as it has been enacted in the Belgian Companies Act, namely allowing the issue of new shares without any reference to the par value of the old shares and having a general meeting decision –never a mere board decision- that decides that all shares have the same accountable par and therefore the same rights. Since this decision has to be taken with the same majority as the decision to increase capital, existing shareholders are sufficiently protected; in a change of class rights-procedure, they would be one class, the new shareholders the other class. This latter group, the new shareholders, is better protected than in a change of class rights-procedure, since their individual decision to buy the shares at the proposed price with certain disclosed rights attached to them, amounts to the same thing as unanimous consent in a class rights variation procedure.

On the other hand, if a legal system mandated nominal values but did not at the same time assume at least as a default proportionality between nominal values and rights attached to shares, how would such a system protect the interest of shareholders? Certainly not through the mandatory use of nominal values. If a legal system allows companies to operate with shares with different nominal values and at the same time leaves it at the discretion of the company to determine the rights attached to shares, with the possibility to deviate from proportionality between rights and nominal value, such a system does not protect shareholder interests at all. Any potential protection does not emanate from nominal value or even fixed nominal value as such, but only from accompanying rules that either exclude deviations from the proportionality principle, or give exclusive power to the general meeting, preferably deciding with some supermajority (i.e. more than 50% of the votes, and votes being determined not per head but proportionate to the percentage of legal capital a share represents) to deviate from this principle. It is striking that the British nominal value system does not contain these safeguards, as opposed to the French system, making it questionable whether the attachment of the British system to nominal value has any purpose at all. Shares in the UK must have a nominal value. A possible legislative switch to no par value shares has

been regularly discussed over the past several decades<sup>67</sup>, but has always been defeated, the last time during the discussions leading to the 2006 Companies Act. It was felt that the 2<sup>nd</sup> Directive did not allow true no par value shares for public companies and that it would be inconvenient to have a different system for private versus public companies. It was also argued that a switch to a no par value system would entail too much cost compared to the benefits. This seems not very convincing as long as at least already existing companies are not forced to switch to no par value shares but are allowed to soldier on with nominal values if they so prefer. Be that as it may, while UK companies must choose a nominal value for their shares<sup>68</sup> and this value seems to be fixed for each specific share<sup>69</sup>, it does seem perfectly possible for UK companies to issue new shares with a different nominal value from the old ones<sup>70</sup> but at the same time give them the same rights (voting; profit rights etc.) as the old ones.<sup>71</sup> It is possible to issue new shares with preferential rights compared to the old ones<sup>72</sup>. As a rule, each share has one vote and profit rights are proportionate to nominal value, but this is only a default rule<sup>73</sup>, so that shares with the same nominal value can have different rights whereas shares with different nominal values can be awarded the same rights. This begs the question what the use of nominal value is under such an extremely flexible system. It's not apparent. When discussing corporate law in the UK, one should also not lose sight of the fact that (in 2009) only about 11.000 companies are public companies<sup>74</sup>: all the others, i.e. the vast majority (more than 3 million), are private companies, in which legal capital and hence nominal value does not necessarily play any role at all.

The third possibility under a traditional par value system to go ahead with a capital increase in a situation where par value is higher than the economic value of the shares, is to issue the new shares at a price equal to the nominal value of the old shares (in the example: issuing the new shares for a price of 100, even though the book value of the old shares is only 80). This leads to immediate dilution of the new shareholders<sup>75</sup>, which will only be acceptable to the new shareholders if they receive preferential rights, i.e. if their shares have higher profit or/and voting rights than the old ones, in spite of having the same nominal value. One could imagine an investor being prepared to pay 100 for shares with a book value of only 80 if the investor receives the right to preferential dividends and/or more votes per share than the old shareholders, enabling him to recoup his "losses" in future and leading him to value these shares at something like 100, in spite of their lower book value. This third solution is only possible in legal systems that on the one hand force companies to use nominal value, but on

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<sup>67</sup> For an overview, see E. Ferran, *Principles of Corporate Finance Law*, Oxford, 2008, p. 87-89.

<sup>68</sup> See section 542 (1) CA 2006. S. 580(1) contains the rule that issues at a discount to par=nominal value are not allowed.

<sup>69</sup> Even though it is possible to subdivide or, conversely, "consolidate" shares, so that a share with a nominal value of 1 £ can be subdivided into 4 shares with a nominal value of 25 p. But this does not change proportions.

<sup>70</sup> *Mayson, French and Ryan on Company Law*, Oxford, 31st ed. 2014-15, p. 160.

<sup>71</sup> P. Davies and S. Worthington, *Gowers and Davies' Principles of Modern Company Law*, London, 9<sup>th</sup> ed. 2012, p. 273, nr. 11-11.

<sup>72</sup> P. Davies and S. Worthington, *Gowers and Davies' Principles of Modern Company Law*, London, 9<sup>th</sup> ed. 2012, p.820.

<sup>73</sup> P. Davies and S. Worthington, *Gowers and Davies' Principles of Modern Company Law*, London, 9<sup>th</sup> ed. 2012, p.819.

<sup>74</sup> B. Hannigan, *Company Law*, Oxford, 2009, p. 476.

<sup>75</sup> Suppose the company initially had 1000 shares with a nominal value of 100 and therefore a legal capital of 100.000. But at the time of the capital increase, the book value of the company, as a result of 20.000 worth of losses, is only 80.000, each share having a book value of 80. The company now issues 1000 new shares with a nominal value of 100, and demanding a contribution of 100 per share. After this operation, the legal capital of the company is 200.000, but its book value is 180.000 (the losses have of course not miraculously disappeared because of the capital increase). The book value of each share will be 90 (180.000/2000), entailing a value transfer of 10 per share from new shareholders to old ones.

the other are flexible enough to allow deviations from the principle that shareholder rights should be proportionate to this nominal value. In which cases the question again arises what the protective function of nominal value or historical accountable par could be? The answer seems to be: virtually none.

There is one seeming advantage from the angle of shareholder protection to using a par value system- either a nominal value system or a system with accountable pars. This advantage is what one could call the signalling or perhaps even the warning light function of par values. If the board of a corporation suggests to its general meeting to increase capital through issuing new shares below the nominal value of the existing shares, this can set off alarm bells with those shareholders, or a flashing message if one prefers, reading “Danger of dilution!”. But of course, as should be clear by now, such a warning system deserves to be called very crude and simple-minded to such an extent that it is misleading. Financial dilution will only take place if the issue price is below the book or market value of the existing shares, not if it is below their nominal value/historical par value. Conversely, an issue price well above par value may still seriously dilute the existing shareholders when book or market values are (much) higher still. Therefore, a “warning system” based on market or at least book values instead of par values is preferable. Of course, for the unsophisticated shareholder, nominal values are easier to understand than book or market values, but historical par values are at least as difficult for such an investor to grasp as book values, and one may assume that an investor who does not grasp the concept of book value is a hopeless case, not worth protecting; at least the whole legal system should not be geared towards these people who had better not make any investment decision themselves but should leave investment decisions to their advisors. It is true that power dilution, that is dilution of governance rights such as voting rights, may take place as a result of an issue below nominal value of the existing shares but not below the book value of those shares, if the new shareholders get the same governance rights per share as the old ones<sup>76</sup>. But such voting rights proportionate to (non-historical) accountable par or simply equal for each share are a normal consequence of market conditions: if a company finds itself in dire financial straits and wants to solve these difficulties by asking for a cash injection, it will have to pay a price to either the existing shareholders or to new investors in the form of some influence for these investors that these would have only received at a higher price had things been going well<sup>77</sup>.

#### **IV. The 2nd Company law Directive does not outlaw true no par value shares.**

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<sup>76</sup> Assume again a company with a share capital of 10.000 divided into 1000 shares without nominal value, therefore having an accountable par of 10. Because of losses of 2000, the book value of the shares is only 8. The company now issues 1000 additional shares for a price of 8. After this capital increase its legal capital will be 18.000 divided over 2000 shares and each share has an accountable par of 9. The book value of all the shares is also the same: 8 (16.000 divided by 2000 shares). No financial dilution has taken place. But each new share has one vote, can lay claim to the same pre-emption rights profit rights, even though the new shareholders only paid 8 per share. But this a consequence of the fact that it was under the watch of the old investors, during a time when they had knowingly entered into a risky contract (namely bought shares in commercial company) that the losses were incurred.

<sup>77</sup> The situation is comparable to when a bank has a claim of say 10 million against a company and agrees with the company, who is in financial distress, to convert that claim into shares. Suppose the bank has only about a 10% chance that its loan would have been fully paid back. It is a rare bank that would accept that this means that its claim would have to be valued at only 100.000 when it is converted into shares: precisely because of the risk associated with the company, the fact that the bank might want to influence the way the company is run and therefore wants a sizeable stake of total equity and because of the weak bargaining position of the company, the existing shareholders will have to accept dilution when the bank converts its claim into shares at face value.

The EMCA suggests that national company law drafters allow the use of true no par value shares. But is this not outlawed by the 2<sup>nd</sup> EU company law Directive? Many seem to believe so –including the majority of those drafting what would become the 2006 UK Companies Act- but they are mistaken. There are basically two reasons why the 2<sup>nd</sup> Directive does not stand in the way of a true no par value system.

First, there is nothing in the wording of the Directive that explicitly outlaws true no par value shares. In fact, the Directive contains no provision whose specific purpose it is to mandate a choice by public companies between shares with and shares without nominal value, nor does it contain a definition of the concept of par value or accountable par. The par value requirement is usually deduced from Article 8.1, which states “*Shares may not be issued at a price lower than their nominal value or, when there is no nominal value, their accountable par*”. But as such, this is simply the “no discount” rule in the limited sense that shares may not be issued for a contribution that is lower than the part of legal capital they represent. It says nothing whatsoever about how “the part of legal capital a share represents” should be calculated, although indirectly it makes of course clear that the part of legal capital a share represents is either indicated by its nominal value, or otherwise by its accountable par. The directive does not define accountable par, but the explanatory memorandum does: “*The accountable par is obtained by dividing legal capital by the number of shares that represent it*”. If anything this wording lends support to the thesis that there is no fixed par value in a system of shares without nominal value and that historical par value plays no role (in other words a confirmation of the Belgian approach, which was indeed the source of inspiration for the Directive).

The best (but still unconvincing) support one can find for the requirement of a fixed par value is in article 3 (c) of the Directive. Art. 3 (b) says that the nominal value of shares must be indicated in the articles; 3 (c) then proceeds to say that the articles must indicate the number of shares subscribed “without *stating* the nominal value, where such shares may be issued under national law”<sup>78</sup>. This could be taken to mean that the only difference between nominal value shares and shares without nominal value is that in the latter the nominal value is not expressed; in other words, we would be dealing with the equivalent of what “Stückaktien” are under German law.

But grasping at the literal text of a section in the Directive that in fact deals with the minimum content of a corporations’ articles in order to invoke this as –very indirect- support for the thesis that true no par value shares are not allowed by the Directive not only reeks of desperation but more importantly is unconvincing in view of the undisputed fact that shares without (stated) nominal value were introduced into the Directive because they were already in use in Belgium, and as explained, in Belgium such shares are not merely shares whose nominal value has not been expressed, they do not have a nominal value at all and their par value is simply the result of a division of legal capital by the number of shares, without taking into account the amount contributed for the share or any historical par value. In Belgium, art 476 Companies Act (French version) states: “*Le capital social des sociétés anonymes se divise en actions (...) avec ou sans mention de valeur*”. Note that neither this French nor the equivalent Dutch text contain the word “nominal”, they only speak of “with or without

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<sup>78</sup> The French and German texts are the same: “sans *mention* de valeur nominale”, “ohne *Angabe* des Nennbetrags” but the Dutch text isn’t, there is no equivalent there of the word “stating” or “mention”: “aandelen zonder nominale waarde” the Directive says, not “zonder *vermelding* van nominale waarde” even though the latter expression is not uncommon in Belgian legal Dutch and is indeed the expression used in art. 476 Belgian Companies Act to indicate shares without nominal value.

mention of value”. This -that the Directive indirectly codified and therefore allowed the Belgian system of shares without nominal value- is the second reason why the Directive cannot be invoked to stop the introduction of true no par value shares.

This finds further support in the Explanatory Memorandum of the Commission Proposal for amending the 2<sup>nd</sup> Company Law Directive<sup>79</sup>. This states (emphasis added-hdw):

*“Shares may not be issued at a price lower than their nominal value, or, where there is no nominal value, their accountable-par. This prohibition applies to all share issues without exception, not just to the initial share issue in the context of the company’s incorporation. **This does not imply that subsequent share issues cannot be made at a nominal or accountable par value lower than that of a previous issue, as long as the price at which the new shares are issued complies with the above mentioned obligation.**”<sup>80</sup>*

This statement is made as part of a summary of what the Commission saw as the main principles of the *existing, original* Directive. This confirms that, in the eyes of the Commission, the Directive never contained a rule forcing member states to take “historical par values” into account. In other words, the Belgian approach to shares without nominal value whereby par value of such shares is simply obtained by dividing legal capital as it is after the capital increase by total number of shares issued and still in existence in the whole history of the company, is compatible with the Directive. In such a system there is no rule that the number of shares may only increase proportionate to the increase in legal capital, as Germany has in § 182 AktG and therefore the formal equality between old and new shares is not maintained; par values fluctuate (without formal capital reductions). If historical par value is not a mandatory feature of shares without nominal value, then such shares *are* really different from nominal value shares, they are not merely the equivalent of German “Stückaktien” but are equivalent in all but name to true no par value shares.

## **V. True no par value systems: EMCA following Finland<sup>81</sup> and common law countries outside the UK**

In a true no par value system, there is by definition no par value and therefore shares have no value that relates to legal capital. In other words, shares do not represent any kind of fraction of legal capital. They are therefore simply issued at a price that is appropriate under the circumstances –meaning of course it was acceptable to both the company and the subscribers- and the rights attached to them (profit rights, voting rights, ..) are determined in the issuing

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<sup>79</sup> Which would lead to the 2006 amendment of the 2<sup>nd</sup> Company Law Directive, Directive 2006/68/EC of the European Parliament and of the Council of 6 September 2006 amending Council Directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital *OJ L 264*, 25.9.2006, p. 32–36.

<sup>80</sup> Commission proposal for a directive of the European Parliament and of the Council amending Council Directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital, COM (2004) 370 Final, 29 October 2004, p. 3. (see <http://eur-lex.europa.eu/procedure/EN/191922>)

<sup>81</sup> On the Finnish system, see esp. M. Airaïnsinen, “The Delaware of Europe? - financial instruments in the new Finnish Companies Act” in P. Krüger Andersen and K.E. Sörensen (eds.), *Company Law and Finance*, Copenhagen, 2008, p. 313. Prof. Matti Sillanpää of the University of Türku first drew the attention of myself and of the whole EMCA group to the Finnish approach and it heavily influenced the drafting of Chapter 5 of the EMCA.

conditions or/and the articles of incorporation, without there being any connection with the percentage of legal capital the share represents. Normally, proposals about the issue price and the rights attached to the shares are made by the directors and usually but not always have to be approved on behalf of the company by the general meeting of shareholders.

The concepts of share premium and issues below par are meaningless in a no par value system.

Contributions for shares are booked either as capital or as a distributable or undistributable reserve at the discretion of the company.

Different issue prices in different capital rounds do neither lead to different classes of shares – since the rights attached to the share bear no relationship with the issue price or non-existing par value- nor to procedures to adapt par value of existing shares to their real value before new shares can be issued at this same (new) par value.

### **1. The Finnish and US approaches**

The approach taken in EMCA has to a large extent been inspired by the new Companies Act that entered into force in Finland on September 1<sup>st</sup> 2006. The centerpiece of that reform was the introduction of true no par value shares<sup>82</sup>. The Finnish government justified this reform by pointing out that nominal value bears no relation to any real value of shares, may create confusion, does not effectively help guarantee equality between shareholders, restricts the possibility to issue new shares when the existing ones have an economic value below their nominal/par value and does not protect creditors, other than through the basic principle that subscribers can be forced to pay up the nominal value of the share<sup>83</sup>.

The Finnish government also pointed out that article 8 of the 2<sup>nd</sup> Directive is not an obstacle to true no par value shares, contrary to what UK and Swedish authorities had contended when they were considering the introduction of such shares in the framework of their own company law reforms and justifies this mainly by a reference to the explanatory memorandum to the Amendment to the 2<sup>nd</sup> Directive that we cited above.

The Finnish approach does not do way with the concept of legal capital, and even retains a minimum capital for private companies (2500 euro). Also, companies can still choose to work with nominal value shares –if they do so, all shares must have the same nominal value.

Companies in Finland have restricted and unrestricted equity (= distributable reserves/retained earnings/surplus). Share capital and the “fair value reserve” are restricted equity. When new shares are issued, the company decides which part of the issue price will be booked as restricted equity and which as unrestricted equity. If no explicit decision is taken by the company, the whole subscription price will be booked as share capital<sup>84</sup>. But the company can decide to issue new shares and credit all of the issue price to unrestricted reserves<sup>85</sup>.

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<sup>82</sup> See M. Airaïnsinen, “The Delaware of Europe? - financial instruments in the new Finnish Companies Act” in P. Krüger Andersen and K.E. Sörensens (eds.), *Company Law and Finance*, Copenhagen, 2008, p. 311-326.

<sup>83</sup> See p. 20-21 of Government Proposal 109/2005 for a new Companies Act, provided to me in English translation by prof. Matti Sillanpää of the University of Türku.

<sup>84</sup> Chapter 9, s 6 (1) Finnish Companies Act 2006.

<sup>85</sup> M. Airaïnsinen, “The Delaware of Europe? - financial instruments in the new Finnish Companies Act” in P. Krüger Andersen and K.E. Sörensens (eds.), *Company Law and Finance*, Copenhagen, 2008, p. 315



By adopting this system, Finland was the first European country resolutely following in the footsteps of the US, where the state of New York was the first to allow companies to issue no par value shares, in 1912. Almost all states now allow corporations to choose between par value and no par value shares<sup>86</sup>. Delaware is among those, and the concept of legal capital still exists in Delaware. The current Model Business Corporation Act (MBCA) has gone further (following California which made this step in the 1970s) and has completely removed any even formal legal relevance of the par value concept, e.g. for distributions<sup>87</sup>. One consequence of the predominance of no par value shares in the US, is that in many states these can be issued in exchange for property or specified services without a specific price or value being put on these contributions; a declaration that such property/services is sufficient consideration is sufficient for corporate law purposes, even though the contributions will still have to be valued in the accounts of the corporation<sup>88</sup>. The issue price for no par value shares is set discretionary by the board<sup>89</sup>, within equitable limits. That is, the board has a fiduciary duty to fix a reasonable price<sup>90</sup>. Basically, the board may not cause unwarranted shareholder dilution in general, nor may price differences for shares that basically share the same features cause one group of shareholders to be diluted to the benefit of others or new subscribers<sup>91</sup>. § 154 of the Delaware General Corporation Law makes clear that the board determines which part of the issue price will be booked as legal capital (and if it fails to do so, the whole price will be considered capital). The rights attached to the shares are freely determined by the company, without reference to legal capital, and are equal unless a preference has been awarded to certain shares<sup>92</sup>. Under Delaware law, the board even has quite broad powers to change the rights attaching to shares after they have been issued<sup>93</sup>. This latter type of provision has not been copied in the EMCA since it would run fundamentally counter to the bedrock of European views on the allocation of powers between the board and shareholders<sup>94</sup>.

## **2. The EMCA: consequences of adopting the Finnish model for determining the rights attached to shares**

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<sup>86</sup> For all that precedes in this paragraph, see e.g. J. Cox and T. Hazen, *Treatise on the Law of Corporations*, 3<sup>rd</sup> edition, West, 2010, Vol. 3, § 16:15, p. 315-16.

<sup>87</sup> As is well-known distributions are mainly subject under this system to a simplified balance sheet test, namely the rule that no distribution may reduce assets below the value of liabilities; and a solvency test: no distribution should render the corporation unable to pay its debts as they mature in the ordinary course of business. See J. Cox and T. Hazen, *Treatise on the Law of Corporations*, 3<sup>rd</sup> edition, West, 2010, Vol. 3, p. 357 with further references. For the tests see also MBCA §§ 140(6) and 6.40 (2008). There is no legal capital concept to limit the distribution of assets, and the balance sheet test is not a net asset test in the vein of art. 15 of the 2<sup>nd</sup> EU Company Law Directive.

<sup>88</sup> See J. Cox and T. Hazen, *Treatise on the Law of Corporations*, 3<sup>rd</sup> edition, West, 2010, Vol. 3, p. 321.

<sup>89</sup> For Delaware, see §§ 150 and 153 (b) from which it appears that the board essentially determines the consideration that is acceptable for the corporation for the shares and determines the issue price.

<sup>90</sup> J. Cox and T. Hazen, *Treatise on the Law of Corporations*, 3<sup>rd</sup> edition, West, 2010, Vol. 3, § 16:21, p. 337.

<sup>91</sup> On this and more generally equitable limits to price setting under the no par value system, see e.g. See J. Cox and T. Hazen, *Treatise on the Law of Corporations*, 3<sup>rd</sup> edition, West, 2010, Vol. 3, p. 337-341; specifically for Delaware, see *Folk on the Delaware General Corporation Law. Fundamentals 2010 edition*, Wolters Kluwer, § 161.2, p. 394-395.

<sup>92</sup> See *Folk on the Delaware General Corporation Law. Fundamentals 2010 edition*, Wolters Kluwer, § 151.4.1, p. 335. The principle can be deduced from § 151 (a) DGCL.

<sup>93</sup> See *Folk on the Delaware General Corporation Law. Fundamentals 2010 edition*, Wolters Kluwer, p. 341.

<sup>94</sup> Broadly speaking and necessarily simplifying, in European corporate law the articles can only be changed by shareholders, everything having to do with legal capital (therefore) can only be decided by the shareholders and the same goes for shareholder rights (embedded in shares representing legal capital or not). By-laws that have a “lesser” status than the articles do not really exist in regular corporations.

As indicated, the EMCA approach of no par value shares has largely been inspired by the Finnish Companies Act. Section 5(1) EMCA offers companies a choice between using nominal value shares along traditional lines and no par value shares –it seemed unwise to allow companies to operate with the two types of shares simultaneously. In case of no par value shares, the company determines the issue price and determines how much of this price will be booked as capital or as a reserve (section 5(3) EMCA). It's at the discretion of the same company body to determine which part of the subscription price that is not booked as capital receives the status of restricted reserve and which part is booked as unrestricted, i.e. distributable reserve. The rights attached to the no par value shares are in principle equal- one vote per share (s. 6 (1) of Chapter 5 of EMCA) and equal profit rights (s. 7(3) chapter 5 EMCA) being the default rule- but deviations are possible in the articles(see below).

But EMCA also aims for consistency. A company would still be allowed to choose for using nominal value shares. If a company opts into a nominal value system, the rights attached to the shares must be proportionate with that nominal value. Such a company may create different classes of shares with different nominal values, but few would do that because of the practical difficulties it creates.

The advantages of a system such as proposed in the EMCA are many<sup>95</sup>. The first and most important one has already been mentioned several times: since historical par values play no role, shares in a capital increase can simply be issued for a price that is reasonable under the circumstances. There is no need to first change the nominal or par value of the existing shares before issuing new shares when the market or book value is below the value for which they were issued, and the issue price, however it is booked, has no impact on the rights attached to the shares so that there is neither a need to create classes to take into account different “values” of shares nor a need to “unify” classes or groups of shares as far as rights are concerned after they have been issued for different subscription prices. In mergers and similar operations, there is no need to “harmonize” nominal or par values of the shares of the companies (whose shareholders are) involved in the share swap. Share capital does not have to equal the sum of any par values. All this prevents shareholders who under a nominal value system would have to vote on these changes from unreasonably blocking a transaction which would be beneficial or even necessary for the company, e.g. to assure its survival when it is in financial distress but a new financier has been found who is ready to inject equity.

The number of shares can be changed (increased or decreased) without new contributions or capital reductions, but also without any internal movement between items in the accounts (e.g. without incorporation of retained earnings into legal capital). Conversely, new contributions need not lead to the issuing of new shares. More generally, because under a no par value system there is no link between legal capital and shares, shares can be issued or their number decreased without changes to legal capital in far more circumstances and far easier than under a nominal/par value system.

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<sup>95</sup> See among quite a few others J. Cox and T. Hazen, *Treatise on the Law of Corporations*, 3<sup>rd</sup> edition, West, 2010, Vol. 3, 320-21; M. Airaïksinen, “The Delaware of Europe? - financial instruments in the new Finnish Companies Act” in P. Krüger Andersen and K.E. Sörensen (eds.), *Company Law and Finance*, Copenhagen, 2008, 314-15; H.Y.Kee and L.L. Luh, “The par value of shares: an irrelevant concept in modern company law”, *Singapore Journal of Legal Studies*, 1999, p.562-568. A quite extensive evaluation of the merits and disadvantages of both a par value and no par value system can also be found in e.g. The Australian March 1990 Companies and Securities Law Review Committee Discussion Paper no 10, *Shares of no par value and partly paid shares*, available at [http://www.takeovers.gov.au/content/resources/cslrc/cslrc\\_discussion\\_paper\\_no\\_10.aspx](http://www.takeovers.gov.au/content/resources/cslrc/cslrc_discussion_paper_no_10.aspx).

Another consequence of the EMCA favouring a no par value system, is that the rights attached to shares are freely determined by the company (articles, issuing conditions). This is more generally in line with the fundamental principle underpinning the whole of the EMCA that mandatory law is only necessary in order to save transaction costs or combat externalities and that therefore, the starting point in all matters should be freedom for the articles of incorporation to deal with issues. After extensive debate, the EMCA group has held onto this line with regards to voting rights attached to shares. Non-voting shares are allowed<sup>96</sup>, without it being mandatory that the lack of voting rights is compensated by preferential profit rights. Even priority shares are allowed, meaning shares that give certain special, exclusive owners to certain shareholders, such as the veto powers or the right to take certain decisions without the support of other shareholders. An example of the latter could be that a certain group of shareholders or even an individual shareholder is allowed to appoint (not just nominate) a director irrespective of the vote at the general meeting. In public companies this may not be ideal from a governance perspective and in listed companies investors will normally not accept such practices, insofar as they are allowed by listing rules. But EMCA was also and perhaps in reality mainly drafted with private companies in mind, and there contractual freedom should prevail so that the governance structure can be tailor-made to the needs of the parties involved.

As a consequence of this approach, the EMCA does, of course, allow multiple voting rights<sup>97</sup>. Under Commissioner McCreevy, the EU Commission considered the issue of 1 share 1 vote and for a while considered making this rule mandatory for listed companies. In 2007 several studies of the issue, commissioned by the EU Commission, were published<sup>98</sup> and based on these and the feedback from stakeholders, the Commission decided to drop its plan for legislation in the area. Even for listed companies, no convincing rationale could be found for the across the board enforcement of a one share one vote rule, at least not as long as deviations from one share one vote had been introduced before the company went public.

Many within the EMCA Group were in favour of the French system of loyalty shares: shareholders who keep their shares for certain period, get double voting rights, but no more, and these double voting rights are attached to a shareholder, not to the shares. Hence, the double voting rights are lost upon transfer of the shares, so that the beneficiary of double voting rights cannot cash in the extra control rights such shares bestow upon him<sup>99</sup>. In other words, multiple voting rights are allowed and the EMCA contains no principle of equality between shareholders in this regard. Contrary to the change effected by the “Loi Florange” in France<sup>100</sup>, EMCA recommends that multiple voting rights would only attach to shares if the company explicitly opted into the system<sup>101</sup>.

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<sup>96</sup> S. 6 (2) Chapter 5 EMCA.

<sup>97</sup> S. 6 (1) Chapter 5 EMCA allows the articles to deviate from the one share one vote rule, without limitations concerning the multiplier which in the view of the EMCA Group are only required in listed companies. Multiple voting rights remain a fascinating issue but it would of course have required a separate article to deal with the issues with any degree of thoroughness.

<sup>98</sup> See [http://ec.europa.eu/internal\\_market/company/shareholders/indexb\\_en.htm](http://ec.europa.eu/internal_market/company/shareholders/indexb_en.htm).

<sup>99</sup> For a brief description of the French rules, see e.g. Ph. Merle, *Sociétés commerciales*, 16<sup>th</sup> edition 2013, Paris, Dalloz, p.374-375.

<sup>100</sup> Loi n° 2014-384 du 29 mars 2014 visant à reconquérir l'économie réelle (loi Florange), French OJ 1 April 2014, 6227.

<sup>101</sup> The “loyalty double voting rights” system has received some renewed attention over the past few years because of the controversial changes made to the French system by the “Loi Florange” (previous footnote) and the introduction of a similar system in Italy, where the initial version of the law –which was apparently introduced after Fiat incorporated in the Netherlands, a jurisdiction which is lenient towards anti-takeover defences, on the occasion of its merger with Chrysler- was immediately repealed after vehement protest by some

## Conclusion

Our conclusion can be brief. National legislators should follow the EMCA's recommendation to introduce no par value shares on the Finnish model. The 2nd directive is, contrary to what is often alleged and what UK and Swedish company law reformers clearly believed, not an obstacle. As long as one does not force at least private companies to switch to the new no par value system, but allows them to soldier on with nominal value shares if they so wish, or gives them a long grace period, there are no serious cost objections and the Belgian example shows that it is completely unproblematic to allow a nominal value and a no par value system to coexist, depending on companies' choices. The current rules on par value do not protect stakeholders –neither creditors nor shareholders- but may on the contrary have a negative impact on the ease with which firms in financial distress are able to raise new finance. By mandating supermajorities and sometimes individual creditor consent for the issue of new shares below par of the old ones, the current rules may even give an opportunity to a relatively small group of shareholders to take the company hostage: out of fear of being diluted they could block the capital increase that could save the company and the economic substance (including often employment) it represents. The objection that such abuses can be combatted using doctrines like “abuse of minority voting power” or “unfair prejudice” is not very convincing in view of the very limited scope of these doctrines, the burden of proof they impose on plaintiffs and the simple fact that there is often not enough time to go to court when a company is in distress and wants to raise finance to avoid total collapse.

In a no par value system, one has to rely more on directors' duties than on any bright line rule related to par value to make sure that an acceptable issue price for new shares is determined. It is no doubt true that enforcement of directors' duties is not a *forte* of European company law, certainly not on the continent. But this does not make the bright line rules that refer to par value, such as the “no discount” rule, any more attractive. These rules are unable to protect stakeholders in any meaningful way, and even in a par value system, the discretion of directors to *de facto* determine the issue price is large.

It is therefore to be hoped that Europe's national legislators, when they next set out to reform their national companies acts, get rid of the cobwebs of par value that currently obstruct a clear view of what is happening to the company and relations between existing and new shareholders when it raises new equity<sup>102</sup>.

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institutional investors. For an overview of the rules and the debate, see J. Delvoie and C. Clottens, “Accountability and short-termism: some notes on loyalty shares”, *Law and Financial Markets Review*, Vol. 9:1, 2015, p. 19-28.

<sup>102</sup> I'm part of a committee drafting a completely new Belgian Companies Act that is suggesting to do just that for Belgian companies- for private companies the intention is even to get rid of the concept of legal capital (not just of minimum capital). In 2017 it should be clear whether the Minister of Justice will be successful in getting this reform through Belgian Parliament. This 4 person committee tries, with the help of various other experts and after extensive consultations with stakeholders, to implement the ideas of the Belgian Center for Company Law, a group of originally 14 company law professors, one of whom, Koen Geens, has in the meantime become Belgium's Justice minister. For some of the key documents concerning the Center's activities including a summary of the key proposals now being transformed into a draft bill, see <http://www.bcv-cds.be/> (Dutch and French only). In Poland, a draft law was published in a law review in 2010 which would have introduced no par value shares, but this law was not/has not yet been adopted: A. Opalski, K. Oplustil, T. Siemiątkowski, S. Soltysinski, A. Szumanski, J. Warchol, “Projekty reformy struktury majątkowej spółki z o.o.”, *Przegląd Prawa Handlowego* 2010, nr 12, p. 5. I thank dr. Adam Opalski for providing me with the paper in English about this draft bill which he presented at the September 2012 Cologne meeting of the ECLE Group.